

# Relationship Between the Renminbi Internationalization Strategy and the Digital Yuan, and the Future Outlook\*

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## **Abstract**

China's internationalization of the Renminbi began in the aftermath of the global financial crisis in September 2008 with the introduction of Renminbi-denominated trade settlement in July 2009. It was strategically advanced with a view to the inclusion of the Renminbi in the International Monetary Fund's (IMF) Special Drawing Rights (SDR) basket, which came about in 2015. During this time, China continued to promote the internationalization of the Renminbi through a unique approach that included the establishment of Renminbi clearing banks, concluding Renminbi-denominated currency swap agreements, allocating Renminbi-denominated investment quotas for Qualified Foreign Institutional Investors (RQFII), and establishing the Stock Connect scheme, a mutual transaction system with Hong Kong for cross-border securities investment. After the exchange rate reform of August 2015, China experienced a temporary capital outflow, but the policy of Renminbi internationalization remained unchanged, and it continued to make efforts to improve the cross-border securities transaction system. As for digital yuan, although it has been primarily used in the domestic retail sector, joint research efforts are also underway toward application in the area of international settlements. In the future international monetary system, China's strategy is to strengthen the Renminbi's presence within the frameworks of institutions such as the IMF and regional financial cooperation. However, to further advance the internationalization of the Renminbi, China needs to address the trilemma of international finance, including relaxing regulations on capital movements.

Keywords: Internationalization of Renminbi, Special Drawing Rights (SDR), Renminbi International Settlement Systems (CIPS), Digital Yuan

JEL Classification: F3, G1, N2

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## **I. Introduction**

The Chinese government used the name “internationalization” for the renminbi in its official document in the presentation document of the Central Economic Work Council<sup>1</sup> held

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<sup>1</sup> An important meeting in which the Communist Party of China (CPC) and the State Council decide the basic policy of economic policy management for the next year. In 2014, it was held from December 9 to 11th.

in December 2014, which clearly stated that it would “steadily promote the internationalization of the renminbi.” The expression of “renminbi internationalization” is one step further from the expression of “improvement of trade convenience” by promoting renminbi settlement after the occurrence of the global financial crisis in September 2008. In other words, it was perceived by market participants at that time as a shift to a strategy to widely promote international settlement in the renminbi and to raise the international position of the national currency.

Also, behind the promotion of the internationalization of the renminbi was the goal to realize the adoption of the renminbi as a component currency of the Special Drawing Rights (SDR) of the International Monetary Fund (IMF).

In response to the aforementioned global financial crisis, then Governor Zhou Xiaochuan of the People’s Bank of China (Central Bank) (at that time, Pan Gongsheng is now president) pointed out the limitations of the international monetary system, in which a specific currency doubles as a reserve currency, with the U.S. dollar in mind, in a paper titled “Considerations on the International Monetary System” published on March 23, 2009. At the same time, he proposed the creation of a reserve currency, the so-called “Super Sovereign reserve currency,” which goes beyond the boundaries of sovereign states, and proposed that the SDR of the IMF should be utilized as reserve currency.

The promotion of renminbi internationalization continued in the 14th Five-Year Plan (2021-2025) even after the adoption of the renminbi as a component currency of the SDR in November 2015, although adjustments were made in terms of the speed of deregulation of key capital transactions. In 2020, the People’s Bank of China announced a plan to issue a Central Bank Digital Currency (CBDC), and since autumn of the same year, experiments have been conducted on the issue and distribution of a region-limited digital yuan (e-CNY). After that, the experiment of the cross-border settlement of the digital yuan with the Hong Kong market and the joint research for the international transaction of the CBDC with the Bank for International Settlements (BIS) and the financial authorities of Asia and the Middle East started, and the existence of the digital yuan is noticed from the international financial world in the trend of the renminbi internationalization.

In this paper, the progress of the renminbi internationalization since the beginning of the 21st century is examined according to several periods. In particular, it focuses on the deregulation of capital flows with a view to adopting the SDR component currency and the subsequent movement toward internationalization. And, introduction and demonstration experiment trend of digital yuan, and movement toward international trade are taken up. Finally, we examine how the Chinese government intends to promote the internationalization of the renminbi in the short term and position it in the future international monetary system in the medium and long term.

## II. History of Renminbi Internationalization

The progress of the renminbi internationalization can be seen in the periodization before

and after the events of China's accession to the World Trade Organization (WTO) in December 2001, the global financial crisis in September 2008, and the adoption of the renminbi's SDR component currency in 2015. In addition, the People's Bank of China first published the "White Paper on the Internationalization of the Renminbi (2015)" on June 11, 2015, before the adoption of the SDR component currency of the renminbi.<sup>2</sup> Since then, the white paper has been published annually until 2022. The internationalization of the renminbi is a process in which China has a trilemma (free capital flows, fixed exchange rates, and independence of monetary policy) in international finance, and while giving priority to the independence of monetary policy and the stability of the exchange rate, it gradually realizes the free convertibility of its currency and deregulates capital transactions while improving domestic finance and capital market. This process of internationalization of the renminbi is divided into the first stage of international trade calculation and settlement units, the second stage of operational means, and the third stage of international reserve currency according to the definition of the Hong Kong Trade Development Bureau. Based on the above-mentioned white paper, the progress of the internationalization of the renminbi in each period can be summarized as follows (Figure 1).

### *II-1. Deregulation of cross-border securities trading after accession to the WTO on December 1, 2001*

As the first step of the renminbi internationalization, the following deregulation of capital transactions was carried out in the financial field on the occasion of China's accession to the WTO in December 2001.

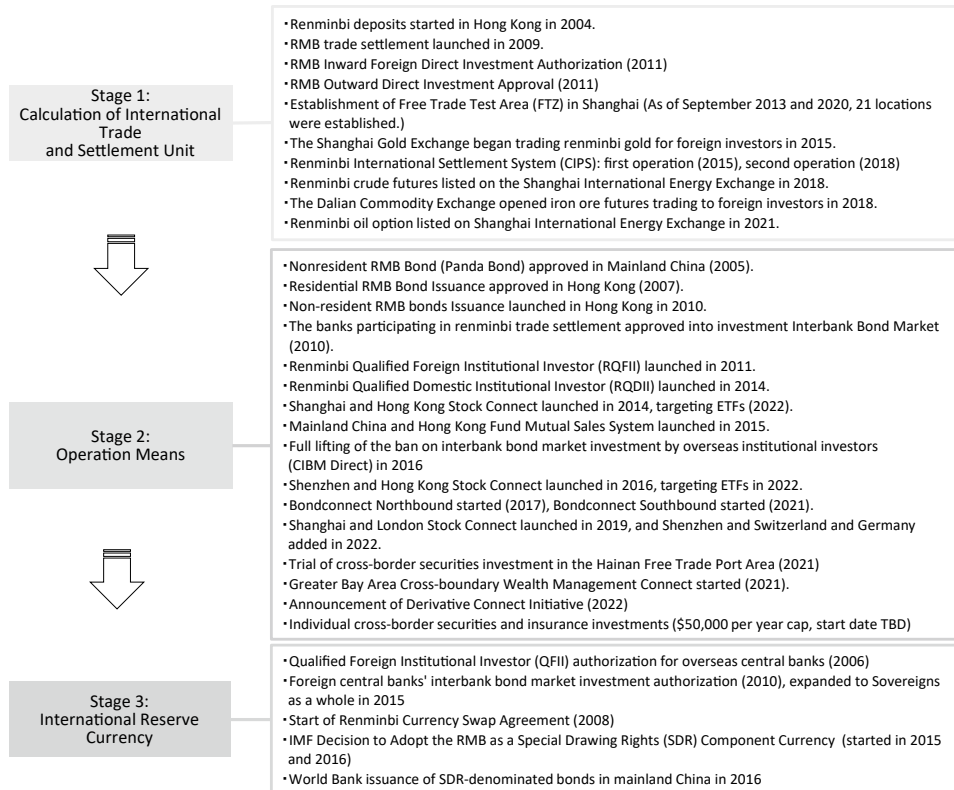
The first deregulation is the Qualified Foreign Institutional Investor (QFII) system, which was established in November 2002 to allow foreign institutional investors to invest in renminbi denominated securities in mainland China. Under the QFII system, institutional investors such as overseas investment management companies, insurance companies, securities companies, commercial banks, and pension funds licensed by the China Securities Regulatory Commission (CSRC) can bring foreign currency into the Chinese mainland market, exchange it into renminbi, and invest in renminbi denominated securities (listed stocks and bonds on stock exchanges, publicly offered investment trusts, etc.) within the limit of the investment limit (amount) approved by the State Administration of Foreign Exchange. The establishment of the QFII system led to the later development of the renminbi inward securities investment system by foreign investors.

The second is the issuance of renminbi denominated bonds in the mainland market (interbank bond market) by multilateral development banks, for which related detailed regulations were established by the Ministry of Finance and the People's Bank of China in February 2005. In October of the same year, the International Finance Corporation (IFC) of World Bank Group and the Asian Development Bank (ADB) issued the first bond at the same time.

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<sup>2</sup> RMB Internationalization Report 2015 <<http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/2879200/index.html>>

Figure 1: Three Steps Toward Currency Internationalization (Functional) and Progress in RMB Internationalization (July 2022)



Source: Nomura Institute of Capital Markets Research, based on data from the Hong Kong Monetary Authority, the People's Bank of China and other sources.

The Ministry of Finance nicknamed the RMB bonds issued by the nonresident “panda bonds,” which led to the subsequent diversification of issuers (overseas business companies and financial institutions) and the expansion of issuers and issuance markets.

The third is the Qualified Domestic Institutional Investor (QDII) system established in April 2006, which allows domestic institutional investors to invest in securities in overseas markets. Under the QDII system, institutional investors such as investment management companies, commercial banks, insurance company, securities companies, and trust companies in China licensed by the financial authorities of each business sector can exchange renminbi into foreign currencies within the investment limits approved by the State Administration of Foreign Exchange.<sup>3</sup> The experience of the foreign securities investment by the QDII system became the material for the improvement of the bilateral cross-border investment system later.

<sup>3</sup> The establishment of the QDII system was also aimed at easing the upward pressure on the renminbi from overseas as a financial authority by providing domestic institutional investors with opportunities for international diversification and creating exchange transactions for selling the renminbi and buying foreign currency.

## *II -2. After the Global Financial Crisis in September 2008*

### **II-2-1. Testing the RMB Trade Settlement**

The chain failure of the U.S. financial institution which arose with the business failure of Lehman Brothers in September 2008 became the global financial crisis, and it caused the worldwide recession. Therefore, export value and growth rate from China also deteriorated drastically from the end of 2008 to the beginning of 2009. In November 2008, the Chinese government announced economic stimulus measures amounting to 4 trillion yuan to expand domestic demand and embarked on measures to support exporters. As part of these measures, the introduction of renminbi denominated trade settlement to enable exporters to reduce the risk of fluctuations in the renminbi exchange rate was considered.

Subsequently, on December 24, 2008, the Standing Council of the State Council (Cabinet) decided to introduce, on a trial basis, RMB settlement for (1) trade transactions between Guangdong Province and Yangtze Delta Region (Shanghai, Jiangsu, Zhejiang) and Hong Kong and Macao, and (2) trade transactions between Guangxi Zhuang Autonomous Region and Yunnan Province and ASEAN. These two areas on the mainland side of China were the areas in which exporters were hit the hardest in recession worldwide. As the year changed into 2009, on April 8, the Standing Council of the State Council selected 5 cities of Shanghai City, Guangzhou City, Shenzhen City, Zhuhai City and Dongguan City in Guangdong Province on the test area of mainland China. The promotion of RMB-denominated trade settlement was also included in the Shanghai International Financial Center plan approved by the State Council on April 14 of the same year. On June 29 of the same year, the People's Bank of China signed a memorandum of understanding with the Hong Kong Monetary Authority (HKMA) on the testing of RMB trade settlement.

On July 2, 2009, the People's Bank of China, the Ministry of Finance, the Ministry of Commerce, the General Administration of Customs, the State Administration of Taxation, and the China Banking Regulatory Commission (CBRC, at that time) jointly promulgated the "Cross-border RMB Trade Settlement Trial and Administration Rules" and the Q&A (which came into effect on the same day), and on the following day, on the 3rd, the People's Bank of China promulgated the "Detailed Regulations for Implementation of the Cross-border RMB Trade Settlement Trial and Administration Rules" (which came into effect on the same day), and RMB denominated trade settlement (trade in goods) began in the above areas. In the test area on the mainland side, each local government selected 365 companies as the first group of companies which can participate in the RMB trade settlement.

### **II-2-2. Establishment of RMB Clearing Bank**

In China, two routes were established when RMB trade transactions were tested between mainland China and Hong Kong and Macao in July 2009. The first is the route taken by correspondent banks in mainland China on behalf of foreign banks participating in RMB trade settlement.

The second method is to establish RMB Clearing Bank in the offshore market of Hong Kong and Macao, and to carry out cross-border settlement and clearing of RMB through the bank. China's renminbi, which is subject to restrictions on capital flows, is split between the onshore market in mainland China and the offshore market outside mainland China. Therefore, when settlement of RMB in the offshore market is carried out, settlement may not be completed only with RMB in the offshore market. In this case, payments must be made in the offshore market using funds raised in the onshore market (including funding from the People's Bank of China). In order to prepare for such a situation, the People's Bank of China has designated a bank that can operate in the onshore market as a RMB clearing bank so that it can settle funds in the offshore market without problems.

As a condition to be designated as RMB Clearing Bank by the People's Bank of China, it is necessary to have already joined China Modernized Payment System (China National Advanced Payment System, CNAPS), which is the bulk payment system of the People's Bank of China. The RMB Clearing Bank will also be able to participate in the interbank market (renminbi, foreign currency) in mainland China after being approved by the Shanghai headquarters of the People's Bank of China. The Bank of China (Hong Kong) Co., Ltd. in Hong Kong and Bank of China (Macao) Co., Ltd. in Macao were designated as RMB clearing banks at the beginning of the test of RMB denominated trade settlement.

### II-2-3. Conclusion of Renminbi Currency Swap

In testing the RMB trade settlement with Hong Kong, on January 20, 2009, the People's Bank of China and the HKMA concluded the renminbi currency swap of 200 billion yuan (equivalent to HK \$227 billion).

In the traditional currency of swap, the purpose is to supply short-term liquidity to the financial market mutually, but under the Chinese renminbi currency of swap, the main purpose is not only to provide financial accommodation in an emergency, but also to artificially supply the renminbi necessary for RMB trade settlement to the counterparty market, to enhance the convenience of trade and investment with the counterparty, and to strengthen economic relations.

### II-2-4. Utilization of the Hong Kong market (offshore RMB market and RMB bonds)

The offshore RMB market in Hong Kong had a special position from the viewpoint of mainland China among the partners for the test of the trade settlement in renminbi.

First, looking at the economic and trade relations between mainland China and Hong Kong, the "Closer Economic and Trade Agreement (CEPA)" was concluded between mainland China and Hong Kong in June 2003 with the aim of propping up the Hong Kong economy, which was hit hard by the Severe Acute Respiratory Syndrome (SARS) epidemic in spring 2003. In the process of propping up the Hong Kong economy by the mainland, the mainland actively attracted tourists from Hong Kong. Therefore, in order to support the circulation of the renminbi in Hong Kong, the ban on accepting renminbi deposits in Hong

Kong banks was lifted in January 2004 (including money exchange and money transfer). From October 2005, the ban on deposits for corporations was lifted for 7 specific industries (retail, food and beverage, accommodation, transportation, communications, healthcare, education) in Hong Kong. Subsequently, the ban on issuing RMB bonds in Hong Kong by mainland Chinese financial institutions was lifted in July 2007 as a means for banks to manage renminbi deposits in Hong Kong (so-called “Dim Sum Bonds”).

In the “Some Opinions on the Promotion of Economic Development through Financial Services for the Time Being” issued by the State Council’s Office on December 8, 2008, the items of Article 30 included support for the development of renminbi operations in Hong Kong, in addition to the promotion of RMB trade settlement with surrounding areas in China. As part of the support measures, in June, just before the start of RMB trade settlement in 2009, RMB denominated bonds were issued in Hong Kong by the mainland corporation of Hong Kong banks (HSBC and Bank of East Asia). Subsequently, in October of the same year, the Chinese government issued its first RMB bonds in Hong Kong.

## II-2-5. Development of the Renminbi Reflux Route from the Hong Kong Market to Mainland China

### (1) Introduction of RMB foreign direct investment (FDI)

Since the start of testing of RMB trade settlement, foreign affiliates have also started to pay attention to RMB FDI in mainland China, which can reduce the risk of renminbi exchange rate fluctuations. As a practical matter, in Shanghai City and Guangdong Province, the regulation of opening an renminbi account for a non-resident which is a major premise of RMB FDI was promulgated in 2009, and it was carried out on a trial basis. The test object area of the RMB-denominated trade settlement in mainland China started from 5 cities in July 2009 and was expanded to 20 provinces in June 2010. In August 2011, RMB-denominated trade settlement became possible throughout China.

On the other hand, although the Ministry of Commerce approved the establishment of foreign companies for FDI to mainland China, there was no provision at the central government level for RMB FDI at that time. Therefore, the Ministry promulgated the “Notice on Related Issues of Foreign Trade Investment Management Operations” on February 25, 2011, and approved RMB FDI for the first time. Subsequently, the People’s Bank of China was in charge of cross-border fund transfers related to the renminbi, and the State Administration of Foreign Exchange was in charge of renminbi account management. The related notification was issued respectively, and the procedures of three sectors for RMB FDI were clarified.

However, even after the procedures were clarified, the local government, which is the contact point for RMB FDI, had different interpretations and operations since the notification is only a pilot phase. Therefore, it was unclear when applications would be accepted or approved. Therefore, the support measures for the Hong Kong offshore RMB market announced by the central government (Vice Premier Li Keqiang, at that time) in August 2011 expanded the area of mainland China covered by RMB trade settlement nationwide, and a

new notification was promulgated by the Ministry of Commerce and the People's Bank of China in October of the same year, and RMB FDI moved from the pilot phase to the full-fledged implementation phase.

## (2) Establishment of RMB Qualified Foreign Institutional Investor (RQFII) Scheme

At the beginning of the test of the RMB-denominated trade settlement, the amount was stagnant, and one of the causes was the security of the renminbi operation means in the off-shore market. In order to secure investment routes from Hong Kong, where renminbi funds are especially concentrated, to the mainland of China, the aforementioned support measures for Hong Kong in August 2011 announced the establishment of a RMB denominated Qualified Foreign Institutional Investor (RQFII) system in mainland securities companies and management companies in Hong Kong.

The investment limit in the Chinese mainland market (for bonds) through RQFII was initially set at 20 billion yuan, and an additional 50 billion yuan was set in April 2012, and an additional 200 billion yuan was set in November of the same year, bringing the total to 270 billion yuan. In March 2013, restrictions on the acquisition of RQFII qualifications were relaxed and expanded to include (1) Hong Kong branches and Hong Kong subsidiaries of commercial banks and insurance companies in mainland China, and (2) Hong Kong-registered and managed foreign financial institutions. The quota of RQFII then was allocated to securities markets around the world as part of the deregulation of RMB denominated inward securities investment ahead of the adoption of the SDR component of the renminbi.

### **III. Adoption of the Renminbi in the IMF's SDR basket currencies in August 2015**

#### *III-1. The Reform Plan of the 3rd Plenum of the 18th Session of the Communist Party of China and the Flow to adopt the SDR basket of the Renminbi*

The internationalization of the RMB began in earnest under the leadership of Xi Jinping, who was elected at the 18th National Congress of the Communist Party of China (CPC) held in November 2012. In November 2013, the year following the Party Congress, the Third Plenary Session of the 18th Central Committee of the CPC adopted the "Decision of the Central Committee of the People's Republic of China on Some Serious Issues in the Comprehensive Deepening of Reform" (Reform Plan).<sup>4</sup>

The 18th Third Plenum Reform Plan, which consists of 15 fields (60 items in total), consists of the following basic concepts: (1) comprehensive reform, (2) emphasis on reform of

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<sup>4</sup> The National Congress of the CPC is held once every five years in the autumn, and important policies of the party are decided and the central committee is elected. The Central Committee executes the resolution of the National Congress during the adjournment of the National Congress, guides the whole business of the Party, and represents the CPC externally. The plenary meeting of the Central Committee is held once a year in autumn. Looking back on the past, the key economic policies of the new administration after the party congress have been adopted by the 3rd Plenum in the following autumn.



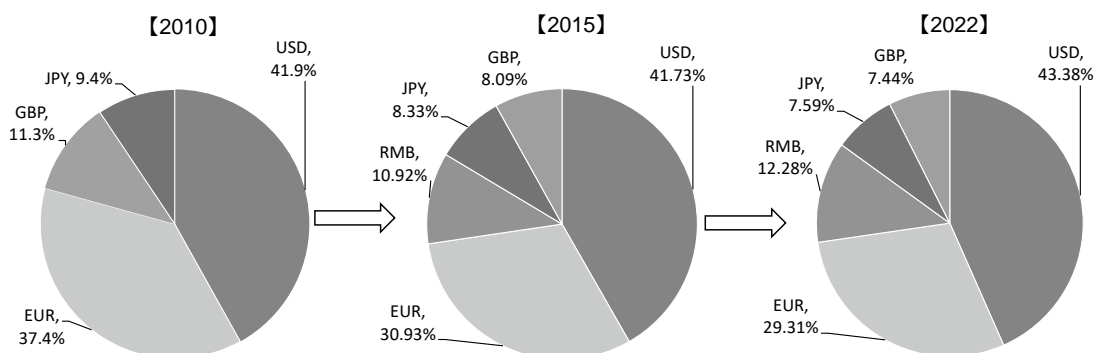
the economic system, (3) timing of achievement of reform to be set in 2020, and (4) establishment of a control organization for reform. It is also characterized by an emphasis on the decisive role of markets in resource allocation. As for the financial sector, in the above 15 fields, the second section, “Accelerating the Development of a Modern Market System,” includes “Developing a Financial Market System,” in which the following reform policies are specified: (1) gradual liberalization of interest rates and the establishment of a deposit insurance system, (2) gradual liberalization of foreign exchange rates, and (3) gradual promotion of free convertibility of capital accounts denominated in yuan. These reforms were also essential to the adoption of the renminbi as a component currency in the IMF’s SDR basket currencies. From around the 3rd Plenum in the 18th period, the establishment of the aforementioned RMB Clearing Bank, the conclusion of renminbi currency swaps, and bilateral financial cooperation diplomacy using the allocation of RQFII investment quotas were also developed with major developed countries and Asian countries.<sup>5</sup>

In October 2015, the 5th Plenary Meeting of the 18th Central Committee of the CPC was held, and after proposals made at the meeting, the “13th Five-Year Plan Outline for the National Economy and Social Development of the People’s Republic of China” was approved at the 4th Meeting of the 12th National People’s Congress (NPC) in March 2016. The 13th Five-Year Plan for the period from 2016 to 2020 sets a doubling of GDP from 2010 to 2020 and an average annual growth rate of 6.5% or more. In addition, the expansion of two-way opening of the financial industry in the establishment of a new system of opening to the outside world (Chapter 50, Section 3) clearly states to “gradually realize the free exchangeability of renminbi capital accounts, increase the free exchangeability and freely usable level of renminbi, gradually promote the internationalization of RMB, and promote the overseas expansion of renminbi capital.” The 13th Five-Year Plan was the first time that “RMB internationalization” was specified in China’s five-year plan. On November 13, 2015, the IMF announced that it had proposed to add the renminbi as a component currency of the SDR. Subsequently, the adoption of the renminbi as a component currency of the SDR was officially decided by the IMF Executive Board on November 30.<sup>6</sup> SDR is a system started by the revision of the first IMF agreement in 1969, and it has the function of reserve assets as “currency supply claim.” The composition of the currency basket of the SDR as of 2010 was determined to be 41.9% for the U.S. dollar, 37.4% for the euro, 11.3% for the pound sterling, and 9.4% for the Japanese yen (Figure 2). The target currency and composition ratio of the basket is to be reviewed every 5 years. In the 2015 review, the U.S. dollar was set at 41.73% and the euro at 30.93%, and the third currency was the renminbi, which was se-

<sup>5</sup> In addition to these three sets of the bilateral financial cooperation, there were also cases in which “direct exchange transactions” with foreign currencies were promoted without using U.S. dollars. In relation to Japan, the framework of Japan-China financial cooperation was agreed upon in 12, 2011, and the direct exchange of Japanese yen and Chinese yuan started in the Tokyo market and the Shanghai market in June 2012, ahead of the world currencies. In addition, the designation of the RMB Clearing Bank in Japan, the resumption of the Japanese Yen/RMB Currency Swap Agreement, and the granting of the RQFII to Japan (200 billion yuan) were agreed upon and realized during the Japan-China Summit Meeting in 2018.

<sup>6</sup> Press Release: IMF’s Executive Board Completes Review of SDR Basket, Includes Chinese Renminbi  
<<http://www.imf.org/external/np/sec/pr/2015/pr15540.htm>>

Figure 2: Composition of the SDR Currency Basket



Source: Nomura Institute of Capital Markets Research, based on IMF materials

lected at 10.92%, the Japanese yen at 8.33% and the pound sterling at 8.09%. Until the end of September 2016, the currency structure as of 2010 was maintained. Subsequently, on May 18, 2022, the IMF Executive Board reviewed the composition of the SDR basket (every five years) and set the ratio at 43.38% for the U.S. dollar, 29.31% for the euro, 12.28% for the renminbi, 7.59% for the Japanese yen, and 7.44% for the pound sterling (effective August 1 of the same year).

### III-2. Conditions for adoption in SDR component currencies

In order for a currency to be adopted as an SDR component currency, the following conditions must be recognized by the IMF: (1) it is issued by a member country whose exports of goods and services in the past five years are large; and (2) it is a “Freely Usable Currency.” At the time of the SDR component currency review in 2010, the IMF determined that the renminbi (1) met the export volume criteria described above, but (2) did not meet the freely usable currency criteria.

Therefore, on April 18, 2015, Governor Zhou Xiaochuan (at that time) of the People’s Bank of China announced at the meeting of the International Monetary and Financial Committee (IMFC) of the IMF held in Washington D.C., the United States, that 35 of the 40 definitions of capital items in the IMF had been fully or partially liberalized and that the government would deregulate the remaining 5 items, including cross-border investment by individuals and issuance of shares by non-residents. Subsequently, on June 11 of the same year, the People’s Bank of China published the “White Paper on the Internationalization of the RMB (2015)” (as mentioned above) and explained that the renminbi meets the conditions for a freely usable currency, referring to the status of international use and trade of the renminbi, related reforms and their progress, and future prospects.

### III-3. Valuation of the Renminbi as a Freely Usable Currency

The IMF defines “freely usable currency,” one of the criteria for adopting SDR constituent currencies, as (1) currency that is widely used in practice for payments in international transactions and (2) currency that is widely traded in major trading markets. Concretely, it is judged from the proportion of currency used in each index of (1) foreign currency reserves of each country, (2) international bank lending, (3) international bond issuance, and (4) international settlement and trade finance. The IMF also states that “freely usable currencies” do not correspond to currencies without capital controls.

Generally, the function as an international currency is judged by (1) the unit of calculation, (2) the unit of payment, and (3) whether it fulfills the value preservation method in both private and public transactions (Table 1). First of all, from the viewpoint of private transactions, the calculation unit in (1) means that the currency is used as an international transaction unit in trade invoices and financial instruments (display currency, contract currency). The payment unit in (2) means that the currency is used as a means of payment for international transactions in trade payments and settlements and financial transactions (money of account, trading currency and intermediary currency). The value preservation means

Table 1: Currency Internationalization and Chinese Renminbi Stages (July 2022)

Function	Private Transaction				Public Transaction			
Calculation Unit	Display Currency	Function as an International Trading Unit	Trade-wise Invoice	The Chinese government is recommending it to Chinese companies	Base Currency	the function of gold or a foreign currency in the case of a fixed exchange rate (peg) against it	Fixed Rate System	None
			Financial Instruments	China allows renminbi gold trading, crude oil futures, crude oil options and steelstone futures			Basket to Other Currencies	Yes
	Contract Currency	International Government bonds					Currency of the SDR	The IMF Executive Board decided to adopt the renminbi in November 2015, and the renminbi was launched in October 2016.
Unit of Payment			Settlement Currency	Functions as a Means of Payment for International Transactions	Trade Payments, Settlement	The Chinese government condones (Test in 2009, expand to mainland China in 2011, lift ban on renminbi cash management in 2014)	Intervention Currency	function as a means of exchange control by monetary authorities
	Intermediary Currency	Settlement and Financial Transactions			The Chinese government condones (The ban on outward and inward foreign direct investment in the renminbi was lifted in 2011, and the renminbi international settlement system (CIPS) was launched in 2015)	Central Bank Swap		
		Value Storage Means	Asset Currency	Function as a Means of Storing International Value by the Private Sector	Cross-border Deposits	Possible, but limited	Reserve Currency	function as a store of international value by public authorities
Cross-border Securities Investment	Gradual opening (RQFII (Renminbi Qualified Foreign Institutional Investor) system started in 2011, Shanghai and Hong Kong Stock Connect started in 2014, Bond Connect started in 2017)				Foreign Currency Reserves of Other Countries	Gradually increasing (Mainly emerging countries, and in developed countries, Norway, the United Kingdom, and Germany)		

Source: Nomura Institute of Capital Markets Research, based on Takatoshi Ito (2011), "The Internationalization of the RMB," Council on Foreign Relations, and People's Bank of China

in (3) means that the currency is used as a means of preserving international value in deposit and securities investment (asset currency). Next, from the perspective of official transactions, the unit of account in paragraph (1) means that the currency is used as an anchor for gold or a foreign currency (base currency). The unit of payment referred to in paragraph (2) means that the currency is used as a means of exchange control by the monetary authority (intervention currency, money of account). Value preservation means referred to in paragraph (3) means that the currency is used by public authorities as a means of preserving international values (reserve currency).

In the following, based on the White Paper on the Internationalization of the RMB (2015) and the deregulation of capital flows, we will sequentially examine what functions the renminbi has performed as an international currency in private and public transactions during the period of the 13th Five-Year Plan from before the decision to enter the SDR as a component currency in 2015 to 2020.

### *III-4. Functions as a Private Transaction*

#### III-4-1. Function as a unit of calculation

##### (1) Trade invoice

In China, with the global financial crisis in 2008 as an opportunity, renminbi settlement for trade transactions has been lifted since 2009 for the purpose of hedging the foreign exchange fluctuation risk of Chinese trading enterprises. Therefore, the Chinese government is recommending to Chinese enterprises that their trade invoices be denominated in renminbi.

##### (2) Financial instruments

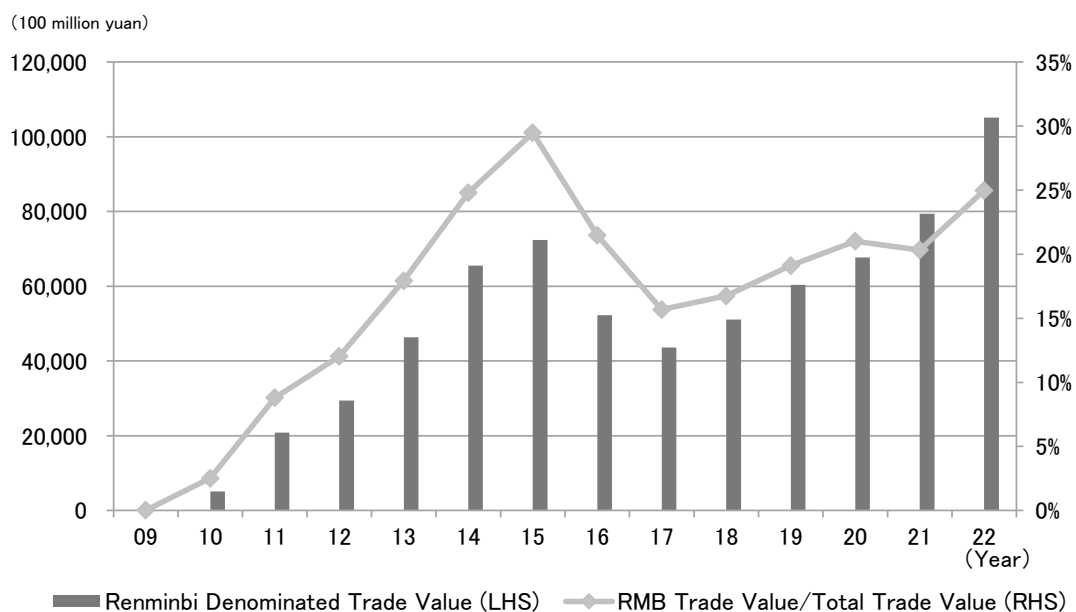
The Chinese government also accepts renminbi quotations for internationally traded financial instruments. Regarding commodities, under the experimental framework of the China (Shanghai) Pilot Free Trade Zone (Shanghai FTZ) established in September 2013, the Shanghai Golden Exchange started a system in which international members (corporations registered outside China) conduct spot trading of gold in renminbi from September 2014. In Shanghai FTZ, in the newly established Shanghai International Energy Resource Trading Center, renminbi crude oil futures trading in which foreign investors can participate started from February 2018.

#### III-4-2. Functioning as a unit of payment

##### (1) Trade payments and settlements

The RMB trade settlement, which started in July 2009, expanded from 3.58 billion yuan in the same year to 7,234.3 billion yuan in 2015, when it was decided that the yuan would be included in the SDR component currency, after the gradual expansion of domestic test regions and overseas markets for settlement partners, reaching its first peak (Figure 3). And the proportion of renminbi-denominated settlement to the total trade amount also expanded from 0.08% in 2009 to 29.5% in 2015.

Figure 3: RMB Trade Value and Ratio (Annual)



Note: Figures through December 2022

Source: People's Bank of China, Customs

## (2) Settlement and financial transactions

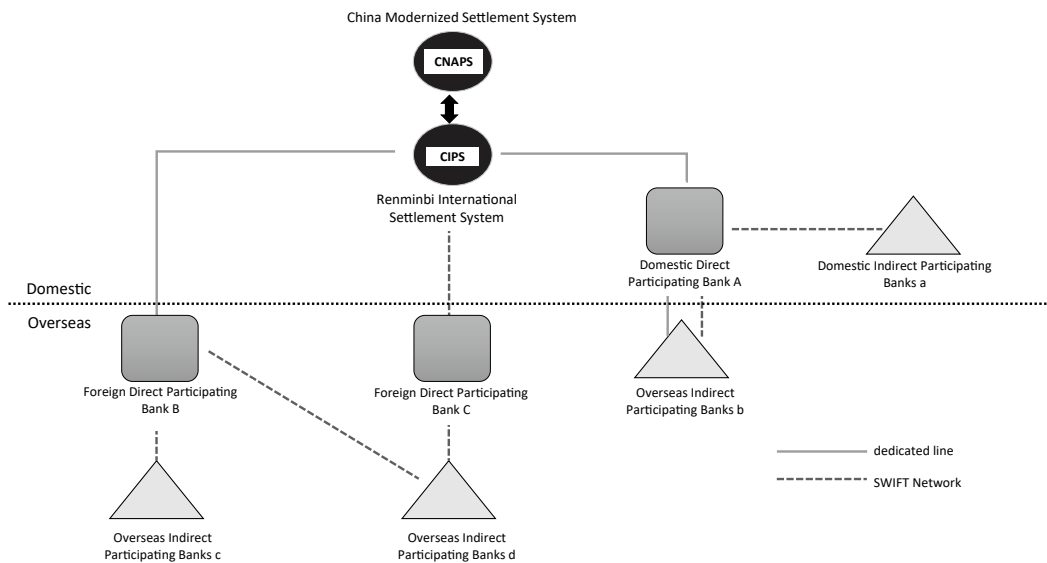
The ban on RMB-denominated direct investment has been lifted since 2011.

First, the ban on RMB-denominated outward direct investment (ODI) has been lifted since January 2011. The amount of ODI in renminbi increased from 20.2 billion yuan in the same year to 186.6 billion yuan 3 years later in 2014. ODI in yuan in 2015 reached 736.2 billion yuan for the whole year. Second, the ban on RMB FDI has been lifted since October 2011 as mentioned above. The amount of FDI in renminbi increased from 90.7 billion yuan in the same year to 862 billion yuan 3 years later in 2014. In 2015, RMB FDI reached 1,587.1 billion yuan for the whole year. In addition, under the experimental framework of Shanghai FTZ, the transboundary cash management of renminbi by Shanghai FTZ enterprises was lifted in February 2014 and was replicated and developed nationwide in November 2014. And, in China, the first phase of renminbi international settlement system (Cross-Border Interbank Payment System, CIPS) which corresponds to the foreign exchange yen settlement system of the Bank of Japan has been operated since October 8, 2015. The CIPS also aimed to enhance the convenience of international settlement of renminbi as a requirement for the adoption of renminbi as a component currency of SDR. Under CIPS, overseas banks can directly participate in the People's Bank of China's system through local subsidiary banks established in mainland China and perform international trade settlement of renminbi.

Participants in CIPS include (1) direct participating banks that have dedicated accounts in CIPS and have direct access to CIPS, and (2) indirect participating banks that participate in CIPS through direct participating banks (Figure 4). When indirect participating banks re-

ceive remittance instructions from overseas remittance clients and request direct participating banks to make remittances, they use the telegraphic message of the Association for Worldwide Interbank Financial Telecommunication (SWIFT). Since direct bank settlements use CIPS telegraphic messages, there is no need to use SWIFT telegraphic messages. The operation time of CIPS is from 9:00 to 20:00 China time in the first stage of October 2015 and “5 weekday business days ×24 hours +4 hours” in the second stage of operation from March 2018. As of the end of March 2023, there were 1,427 CIPS participating banks, of which 79 were direct participating banks and 1,348 were indirect participating banks.

Figure 4: Relationship between CIPS and SWIFT



Source: Nomura Institute of Capital Markets Research

### III-4-3. Value Storage Means

#### (1) Cross-border deposit

The balance of RMB deposits held by non-residents in mainland China has been disclosed since December 2013. The amount of outstanding renminbi deposits held by non-residents peaked at 2,372.2 billion yuan at the end of December 2014, reaching 2.08% of the total outstanding renminbi deposits. According to the latest statistics, the balance of renminbi deposits held by non-residents at the end of December 2022 was 1,741.8 billion yuan, or 0.67% of the total outstanding renminbi deposits.

#### (2) Cross-border securities investment

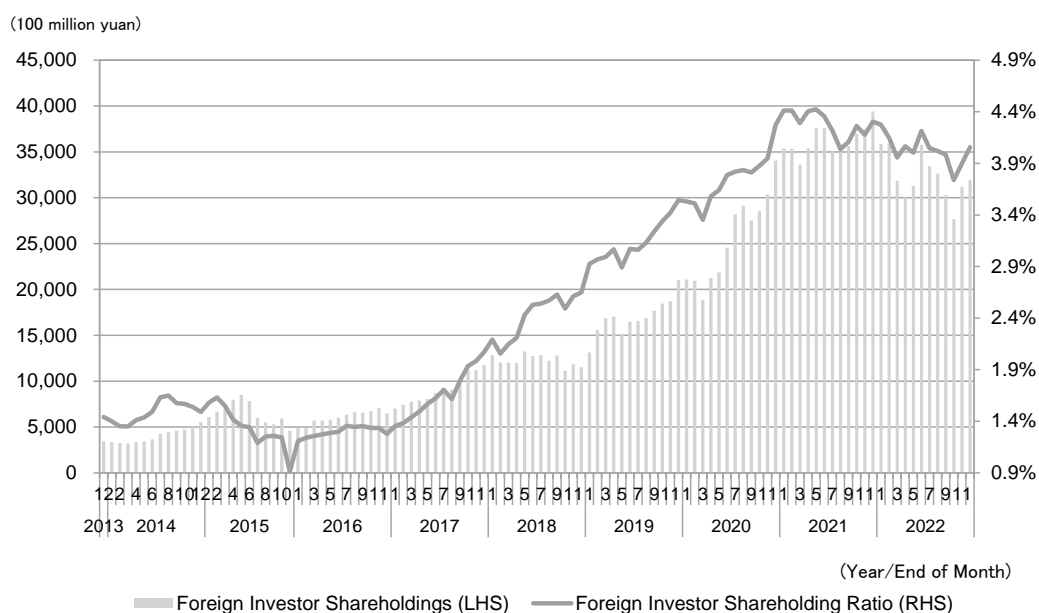
In China, the QFII system was introduced in 2002 and the RQFII system was introduced in 2011 as the inward securities investment system. In addition to the above-mentioned QDII system in 2006, the RMB Qualified Domestic Institutional Investor (RQDII) system was introduced in 2014.

Since November 2014, Shanghai and Hong Kong Stock Connect have also been introduced as a mechanism to conduct two-way stock investment in renminbi for not only institutional investors, but also individual investors. Under Connect, (1) investments are made in both directions from both sides of Shanghai and Hong Kong, (2) investments are made in renminbi, and (3) individual investors can also directly purchase physical stocks, which are the main features different from the existing QFII system. In the reform plan of the 3rd Plenum in the 18th term, the policy of “promoting the two-way opening of the capital market” was incorporated, and it seems that the stock connect was already conceived in the stage of the plan decision. Since July 2015, the mutual sales system of public securities investment funds in Mainland China and Hong Kong (the mutual sales system of mainland China and Hong Kong funds) has been introduced.

Subsequently, Shenzhen and Hong Kong Stock Connect have been introduced since December 2016.

In addition, the amount of shares held by non-residents (foreign investors) in mainland China, as well as renminbi deposits, began to be disclosed in December 2013. Foreign investors’ stock holdings fell after the fall in stock prices and the depreciation of the renminbi in the summer of 2015, but after the inclusion of A-shares in the MSCI index, they started to rise in the latter half of 2017. Foreign investors’ stock holdings reached a record high of 3,942 billion yuan at the end of December 2021, and then fell to 2,768 billion yuan at the end of October 2022 due to the zero-coronavirus policy (Figure 5). At the end of December 2022, foreign investors held 3,196 billion yuan of stocks, accounting for 4.06% of total market cap-

Figure 5: Stock Ownership Trends of Foreign Investors in the Mainland China Stock Market



Note: The end of December 2015 was not available.

Source: Nomura Institute of Capital Markets Research, based on the People's Bank of China

italization.

### *III-5. Function as a public transaction*

#### III-5-1. Units of account

##### (1) Exchange system

The current Chinese renminbi exchange rate system is regarded as a crawl-like arrangement by the IMF. The crawling system is the BBC system based on the fluctuation range (Band), currency basket (Basket) and crawling (Fine-tuning the exchange rate in a certain direction) even in the same controlled floating exchange rate system.

In China, after abolishing the double exchange system and adopting the management float system based on the supply and demand of the market in 1994, it has shifted to the IMF Article 8 country which realizes the free exchangeability of the renminbi of the current trade in 1996. Next, China carried out the exchange system reform leading to the present state in July 2005 through the WTO accession in 2001. First, the renminbi's exchange rate against the dollar was set at 8.11 yuan to the dollar as of 19:00 on July 21, 2005, and it was revalued by about 2%. Second, based on the market supply and demand, the control float system was introduced to the exchange system. Third, the renminbi's exchange rate against the dollar will fluctuate between 0.3% above and below the midpoint announced by the People's Bank of China. The fluctuation range of the exchange rate against the dollar was expanded from 0.3% to 0.5% on May 21, 2007, from 0.5% to 1.0% on April 16, 2012, and from 1.0% to 2.0% on March 17, 2014, after a period of temporary fixing against the dollar from 2008 to 2010.

On August 11, 2015, the People's Bank of China devalued the reference value against the dollar by about 1.8% from the previous day's reference value. On August 12, the reference value was devalued by about 1.6% from the previous day, and on the 13th, it was further devalued by about 1.1% from the previous day. The devaluation of the reference value reached about 4.5% in total for the last 3 days. The People's Bank of China said, "As the reference value deviated from the market rate, the reference value that had been determined based on the rate reported by each bank every morning was changed to a method that emphasizes the closing price of the market on the previous day." On the morning of August 13, the Deputy Governor of the People's Bank of China and the Director-General of the State Administration of Foreign Exchange held a press conference meeting in which they explained that (1) the gap of 3% between the reference value and the market rate had been resolved, and (2) the adjustment of the reference value was advantageous for the internationalization of the RMB. The change of the reference value was to introduce a market mechanism to the exchange rate for the adoption of the SDR component currency of the renminbi. However, due to the depreciation of the stock market and the implementation of stock price keeping operations (PKO) that were underway at that time, the policy intent could not be said to have been sufficiently penetrated by market participants at that time, which led to capital outflow and the depreciation of the renminbi later, and left a problem



for dialogue with the market.

## (2) International government bonds

As mentioned above, the Chinese government first issued RMB-denominated government bonds in Hong Kong in 2009 and has continued to issue them every year since then. Issuance of RMB denominated financial instruments in offshore markets, including Hong Kong, enhances incentives for offshore market participants to hold renminbi.

Then, under the framework of financial cooperation between Britain and China, in October 2014, the British government issued RMB denominated government bonds in the London market and incorporated the proceeds into the country's foreign exchange reserves. The following year, in October 2015, the People's Bank of China issued the first RMB bond outside China.

## III-5-2. Unit of Payment

### (1) Central bank currency swap arrangement

Prior to the RMB trade settlement which started in July 2009, China has concluded the renminbi currency swap arrangement starting from Hong Kong in December 2008. In the traditional currency of swap arrangement, the purpose is to mutually supply short-term liquidity to the financial market, but in the renminbi currency of swap arrangement, the central bank of the partner country is allowed to withdraw the renminbi to increase the convenience of trade and investment.

According to the People's Bank of China's 2022 White Paper on the Internationalization of the RMB, as of the end of 2021, the bank had signed a total of 4.02 trillion yuan in currency swap arrangements with 40 countries and regions.

### (2) Foreign exchange intervention in a third country

Although the Chinese government has not officially announced it, the People's Bank of China appears to have intervened in the offshore market through state-owned commercial banks on September 10, 2015, to buy yuan and sell dollars.<sup>7</sup>

The exchange rate of the Chinese renminbi is divided between the mainland (onshore) renminbi (CNY) and the offshore renminbi (CNH). The former is based on the principle of actual demand and the standard value is also managed by the People's Bank of China, while the latter is not subject to the regulations of the mainland and can be traded freely. The correction of the discrepancy between the CNY and CNH rates is also a point that the IMF has pointed out as a problem in adopting the SDR component of the renminbi. The Chinese government has repeatedly stated that it has not induced the yuan to depreciate since the change of the reference value of the renminbi exchange rate in mainland China in August 2015. It would have intervened in the offshore market to restrain the selling of the renminbi by the people.

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<sup>7</sup> Nihon Keizai Shimbun dated September 12, 2015.

### III-5-3. Value Storage Means

As mentioned above, the United Kingdom is the first developed country to hold renminbi as foreign exchange reserves. The IMF has added the renminbi to its statistics on the composition of foreign exchange reserves since 2016, when the yuan began to be used as an SDR currency. The renminbi increased from 1.1% at the end of 2016 to 2.9% at the end of March 2022 (Table 2).

Table 2: Global Foreign Exchange Reserves by Currency

	Time	USD	GBP	JPY	CHF	CAD	AUD	RMB	EUR	Other
2016	End of December	65.4	4.3	4.0	0.2	1.9	1.7	1.1	19.1	2.3
2017	End of March	64.7	4.3	4.5	0.2	1.9	1.8	1.1	19.3	2.3
	End of June	63.8	4.4	4.6	0.2	1.9	1.8	1.1	20.0	2.2
	End of September	63.5	4.5	4.5	0.2	2.0	1.8	1.1	20.1	2.3
	End of December	62.7	4.5	4.9	0.2	2.0	1.8	1.2	20.2	2.4
2018	End of March	62.8	4.6	4.6	0.2	1.9	1.7	1.4	20.4	2.5
	End of June	62.4	4.5	4.9	0.2	1.9	1.7	1.8	20.3	2.4
	End of September	62.0	4.5	5.0	0.2	1.9	1.7	1.8	20.5	2.5
	End of December	61.8	4.4	5.2	0.1	1.8	1.6	1.9	20.7	2.4
2019	End of March	61.8	4.6	5.3	0.1	1.9	1.7	1.9	20.3	2.4
	End of June	61.3	4.5	5.5	0.1	1.9	1.7	1.9	20.6	2.4
	End of September	61.6	4.5	5.6	0.1	1.9	1.7	2.0	20.3	2.4
	End of December	60.7	4.6	5.9	0.1	1.9	1.7	1.9	20.6	2.5
2020	End of March	61.9	4.4	5.9	0.1	1.8	1.6	2.0	20.1	2.3
	End of June	61.3	4.5	5.7	0.2	1.9	1.7	2.1	20.2	2.5
	End of September	60.5	4.6	5.8	0.2	2.0	1.7	2.2	20.6	2.5
	End of December	58.9	4.7	6.0	0.2	2.1	1.8	2.3	21.3	2.7
2021	End of March	59.4	4.7	5.9	0.2	2.1	1.8	2.5	20.5	2.9
	End of June	59.2	4.7	5.6	0.2	2.3	1.8	2.6	20.6	3.0
	End of September	59.3	4.7	5.7	0.2	2.2	1.8	2.7	20.5	3.0
	End of December	58.8	4.8	5.5	0.2	2.4	1.8	2.8	20.6	3.1
2022	End of March	58.9	4.9	5.4	0.3	2.5	1.9	2.9	20.0	3.3
	End of June	59.6	4.9	5.2	0.2	2.5	1.9	2.8	19.8	3.2
	End of September	59.8	4.6	5.3	0.2	2.5	1.9	2.7	19.7	3.3
	End of December	58.4	4.9	5.5	0.2	2.4	2.0	2.7	20.5	3.5

Source: Nomura Institute of Capital Markets Research, based on IMF

### III-6. Importance of opening bond markets to the outside world

#### III-6-1. Motivation for foreign central banks and monetary authorities to hold the renminbi

The SDR is a synthetic currency used by the IMF to assist member countries with foreign currency shortages, and member countries can exchange their allocated SDR for U.S. dollars, euros, pounds sterling, Japanese yen, and, from October 2016, renminbi as mentioned above. It is the central banks and monetary authorities of member countries that exchange the renminbi and hold it as foreign exchange reserves.

If foreign central banks or monetary authorities add the renminbi to their foreign exchange reserves, they will convert the yuan they hold into renminbi denominated securities. If there are not enough renminbi-denominated securities abroad, the means and routes to operate with renminbi-denominated securities in mainland China are necessary. On the other

hand, if the means and routes of operation in mainland China are not opened, the incentive to possess will not increase. For this reason, the People's Bank of China has been deregulating the bond market in mainland China to secure investment tools and channels for foreign central banks and currency authorities.

### III-6-2. Deregulation targeting foreign central banks and monetary authorities

#### (1) Easing investment regulations in the mainland China bond market

The first action taken by the People's Bank of China was the removal of investment quotas for overseas government-affiliated institutional investors in the mainland bond market. On July 14, 2015, the People's Bank of China issued the "Notice on the use of renminbi in interbank markets by foreign central banks, multilateral development banks and sovereign wealth funds" (the following is the 2015 notification). On August 16, 2010, the People's Bank of China established an investment system in the interbank bond market for foreign central banks and monetary authorities (the following is the 2010 notification) and deregulated as follows.

In the 2010 notification, the target investors were only foreign central banks and monetary authorities, but in the 2015 notification, multilateral development banks and sovereign wealth funds were added.

- Similarly, the investment market was only the bond market, but the call market and foreign exchange market were also added.
- Similarly, the examination and approval system was adopted in the market entry, but it was changed to the registration system.
- In the same way, the operation frame was set, but the operation frame itself was decided not to be set.
- Similarly, orders and execution of bond sales were restricted to the People's Bank of China, but orders and execution were also made available to commercial banks with licenses.

#### (2) Allowing entry into the mainland foreign exchange market

In response to the 2015 notification, the People's Bank of China published on September 30, 2015, detailed regulations for foreign government-affiliated institutional investors to enter the mainland foreign exchange market. The points are as follows.

The registration system is adopted as well as the interbank market.

- There is no upper limit on the investment amount.
- Commodities that can be traded shall be spot, forward, swap, option, etc., and no restrictions shall be set.
- They can also become direct members of the foreign exchange market and place orders with the People's Bank of China and licensed financial institutions.

The free access to currency hedging products in mainland China for overseas government-affiliated institutional investors made it easier to incorporate renminbi denominated assets into foreign currency reserves (Table 2). On November 25, 2015, the People's Bank

of China announced that the HKMA, the Reserve Bank of Australia (RBA), the National Bank of Hungary (MNB), the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the World Bank Trust Fund, and the Government of Singapore Investment Corporation (GIC) had completed the registration of the first batch (7 institutions in total) in the foreign exchange market. Next, on January 12, 2016, the Reserve Bank of India (RBI), the Bank of Korea, the Monetary Authority of Singapore (MAS), the Bank of Indonesia (BI), the Bank of Thailand, the BIS, and the IFC completed the registration of the second group (7 institutions in total).

Also, on December 23, 2015, the People's Bank of China and the State Administration of Foreign Exchange announced that they would extend the trading hours of the renminbi in the Shanghai foreign exchange market from January 4, 2016. Conventionally, it is 7 hours from 9:30 AM to 4:30 PM, but after the extension, it becomes 14 hours until 11:30 PM, and the transaction time doubles. This will make it more convenient for foreign investors to trade currency in mainland China.

### III-6-3. Deregulation in the interbank bond market for overseas institutional investors

#### (1) CIBM Direct Implementation

As mentioned above, the ban on investment in the interbank bond market by overseas financial institutions, etc. was first lifted for banks handling RMB denominated trade settlements by the 2010 Notification. Subsequently, a notification issued by the People's Bank of China on February 24, 2016 (the following is Public Notice No. 3 of 2016), allowed more overseas financial institutions, etc. to invest directly in the interbank bond market without setting limits on investment limits and without using QFIIs or RQFIIs. This new investment system is called "CIBM Direct" using the abbreviation of China Interbank Bond Market. Under CIBM Direct, overseas financial institutions are: (1) financial institutions such as banks, insurance companies, securities companies, fund management companies, and other asset management companies established overseas; (2) financial products established by these financial institutions for customers; and (3) institutional investors such as pension funds, charitable funds, and endowment funds that conduct medium- to long-term investments authorized by the People's Bank of China.

#### (2) Bond Connect Implementation

On July 3, 2017, Bond Connect started as a new system for overseas institutional investors to buy and sell interbank bond markets in mainland China via Hong Kong. Under Bond Connect, unlike existing systems such as QFII, investors can open bond accounts with settlement institutions (CMU) in Hong Kong, not in mainland China, and trade directly with market makers in mainland China through an English-language overseas electronic trading platform. And the investment management frame for mainland China is not established like the existing system.

Overseas institutional investors shall register their investors with the People's Bank of

China in advance when trading northbound bonds to the mainland market under Bond Connect. CMU opens a bond account at a clearing house in mainland China and holds bonds in its own name for overseas institutional investors. The currency associated with bond trading can be the renminbi held by overseas institutional investors or the renminbi can be converted by purchasing foreign currencies. At first, it started with the North Bound for mainland China, but as described later, the South Bound was also established as an investment in foreign securities for mainland Chinese investors to trade bonds in the Hong Kong market, and it is a two-way cross-border bond trading system.

#### III-6-4. Revitalization of the panda bond market

Regarding panda bonds, the Ministry of Finance became the application window, and the rules were established as mentioned above in 2005, and international development financial institutions such as the ADB and the IFC have issued them. In 2010, the qualification of the issuer was expanded to the bilateral public organizations, but the issuance result has not changed especially. The turning point was March 2014, when Daimler, Germany, issued panda bonds using the registration format specified by the self-regulatory organization (China Interbank Market Merchants Association, NAFMII) of the interbank bond market, apart from the above scheme in which the Ministry of Finance became the application reception desk. In September 2015, Bank of China (Hong Kong) and HSBC (Hong Kong) became the first international commercial banks to issue panda bonds. Subsequently, in November of the same year, China Merchants Bureau Group (Hong Kong) issued panda bonds for the first time as a non-resident company of mainland China.

In addition, the People's Bank of China announced on November 27, 2015, the Government of British Columbia, Canada's plan to issue panda bonds. It became the first quasi-sovereign to issue a panda bond, which was issued on January 21, 2016. In addition, the Korean government agreed with the Chinese government to issue panda bonds in mainland China under China-Korea financial cooperation and issued them on December 15, 2015. The Korean government's case was the first issuance of panda bonds by a sovereign. The issue amount of panda bonds has increased rapidly from 13 billion yuan in 2015 to 132 billion yuan in 2016. An increase in the number of panda bond issues that are familiar not only to foreign institutional investors but also to institutional investors in general will make it easier to invest in the panda bond market.

#### **IV. Speed adjustment of internationalization after the renminbi is added to the SDR component currency**

##### *IV-1. Incurring capital outflows and strengthening control through administrative guidance (2016-2017)*

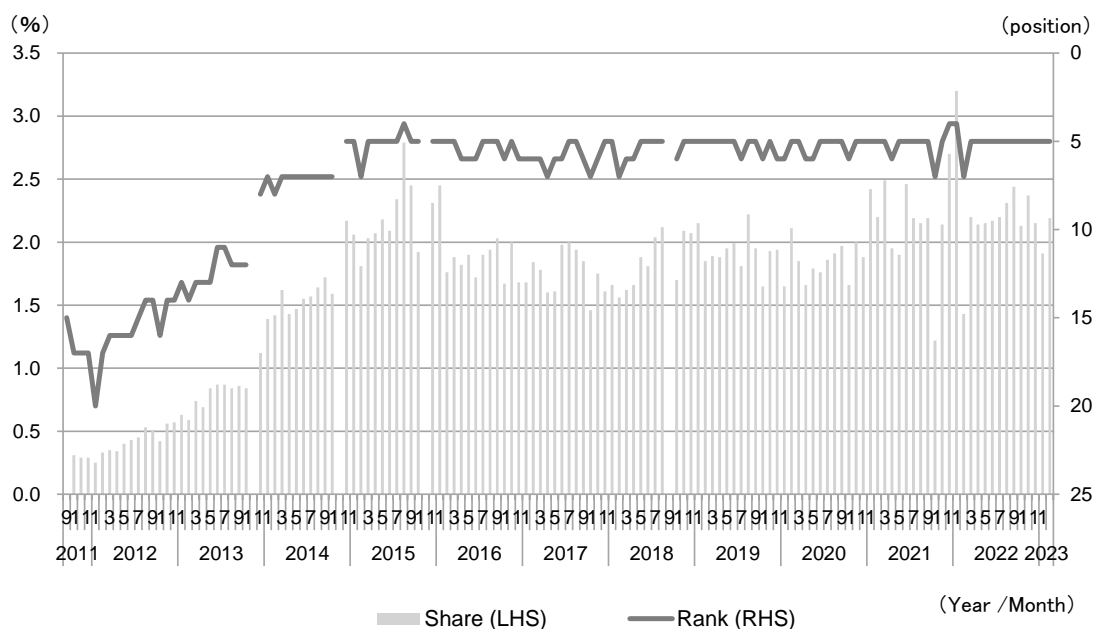
The Chinese government has been deregulating capital flows in the renminbi with the aim of making the renminbi an SDR component currency. However, the exchange rate reform in August 2015 was accompanied by an artificial devaluation, which, together with a decline in the stock market, led to an outflow of funds from market participants who expected further depreciation of the renminbi. It is reported that, although the financial authorities saw capital outflow as a problem because the yuan's depreciation did not stop, they started to control capital outflow through commercial banks and through administrative guidance because they ostensibly advocated "liberalization" and "deregulation."

According to the *Nihon Keizai Shimbun* dated February 1, 2017, and March 18 of the same year, capital outflow regulation by administrative guidance is divided into two stages. The first was from the beginning of 2016 to the middle of the year. At this stage, the policy was mainly to prohibit the advance repayment of the foreign currency debt of enterprises in principle and to submit the foreign currency exchange plan of client enterprises in advance. Second, from the end of November 2016 to the beginning of 2017, in addition to providing guidance to banks so that the amount of foreign currency sold by customers would not be "inversely different" from the amount purchased, the following guidance was provided: (1) the maximum amount of a "child-parent loan" to be lent to a parent company by a foreign subsidiary in mainland China with internal reserves should be 30% of the capital, and advance notification should be required; (2) the amount of outflow and inflow of the renminbi across the border should be controlled to a certain ratio; and (3) the exchange of more than 5 million dollars per direct investment should be approved in advance. For this reason, some banks have requested customers to delay the timing of remittances. And, in January 2017, the submission of the application form is also required for the foreign currency exchange of the individual.

In addition to administrative guidance on these remittances, the State Administration of Foreign Exchange has announced since the end of 2016 a policy to strengthen supervision of cases of irrational investment, investment in businesses other than the core business, and investment where the size of the subsidiary exceeds that of the parent company in areas such as real estate, hotels, movies, entertainment, and sports clubs. Alarmed by capital outflows, the bureau temporarily suspended the increase in the QDII quota.

On a quarterly basis, trade settlements in renminbi peaked at 2,089.2 billion yuan from July to September in the same year, 2015. Looking at the volume of SWIFT's international exchange transactions, it ranked fourth in August, when the IMF was considering the adoption of the renminbi as a component currency of its SDR, and its market share peaked at 2.79% in August 2015 (Figure 6).

Figure 6: RMB Trends in Global Foreign Exchange Market Trading Volume



Note 1: Figures through February 2023.

Note 2: The share in September 2011, and the ranking and share in November 2013, November 2014, November 2015, September 2018, were not available.

Source: Nomura Institute of Capital Markets Research, based on SWIFT

#### IV-2. *Deregulation with a view to responding to the trade friction between the United States and China (Autumn 2017-2018)*

##### IV-2-1. Promoting the outward opening of finance as FDI

In 2017, the Chinese government launched a new foreign investment policy with the protectionist trade policy of the U.S. Trump administration in mind. The first is the “Notice on some measures to expand the opening to foreign countries and to actively use foreign capital” announced by the State Council on January 17, 2017. The second is the “Notice Concerning Some Measures to Promote Foreign Investment” (Notice No. 39) announced by the State Council on August 16, 2017. In all the notifications, the following are common: (1) the aim of further easing restrictions on foreign capital entry, (2) the priority target industry is the service industry, and (3) the main industry of the service industry is the financial industry, especially banking, securities, and insurance.

Subsequently, in the political report of the 19th Party Congress of the CPC in October 2017, when the second Xi Jinping leadership was inaugurated, the long-term goal to realize the construction of a “socialist modernizing strong country” from 1949 to the middle of this century, when the foundation of the country is 100 years old, was set, and the medium-term goal of 2 stages up to 2035 and thereafter was set. In order to realize long-term economic

goals, the financial industry has included policies to (1) deepen the reform of the financial system, (2) increase the ratio of direct financing, and (3) promote the sound development of various capital markets from the viewpoint of accelerating the enhancement of the socialist market economy system. Second, from the viewpoint of promoting a new framework of full opening, the following policies were included: (1) full implementation of pre-entry national treatment and negative list system, (2) substantial relaxation of market entry conditions, and (3) expansion of opening of the service industry to the outside world. In November of the same year, following President Trump's visit to China, the Chinese government announced the relaxation of restrictions on foreign investment in the financial sector (banks, life insurers and securities companies). In particular, in summit securities sector, the ceiling on foreign investment was raised from 49% to 51%, and China pledged to abolish the ceiling three years later. The elimination time was later carried out one year in advance.

Subsequently, on April 10, 2018, President Xi Jinping made a keynote speech at the Boao Asia Forum held in Hainan Province, China, in which he noted that this year marks the 40 year anniversary of the opening of China to reform, which began in 1978, and stated that China would continue and expand its opening to the outside world. Next, it declared that the important measures consisting of four fields for the expansion of the external opening would be taken. In the major relaxation of the market entry regulations among the four targeted fields, the following were described in the policy of introduction of foreign capital in China: (1) the upper limit of foreign capital investment in the banking industry, securities industry, and life insurance industry, which has been classified as "restricted class" in terms of foreign capital investment ratio and license, is loosened and substantially opened at the same time, and (2) the regulation of establishment of foreign financial institutions is relaxed to expand the business scope in China. And, in order to realize the deregulation of foreign investment entry of the financial industry, the conversion work from the positive list system which has managed the specific investment field by dividing into three types of "encouragement," "restriction" and "prohibition" to the negative list system which does not set the restriction in principle in the investment field and manages the restriction and prohibition as an exception was completed in the first half of 2018, and the new foreign investment introduction policy based on the national treatment before entry was realized.

On April 11, the day after President Xi's declaration, the new Governor of the People's Bank of China, Yi Gang, who had just been elected as the successor of Governor Zhou Xiaochuan at the first session of the 13th NPC held in March, stated in his speech at the forum that the opening of the financial industry to the outside world would be carried out in compliance with the following three principles: (1) to be based on the national treatment before entry and the negative list approach; (2) to combine exchange rate reform with the progress of free convertibility of capital items; and (3) to emphasize the prevention of financial risks and to match the level of management and supervisory capabilities with the level of opening. Then, the measures (open 12 items) consisting of 6 items to be carried out within next few months and 6 items to be carried out within 2018 were announced.



#### IV-2-2. Improving and Enhancing Convenience of Cross-border Securities Investment System

Of the 12 open items, there are 2 items of deregulation of capital movement leading to the internationalization of the RMB. The first is a four-fold increase in the daily quota for Stock Connect between mainland China and Hong Kong. The investment quota of Shanghai and Shenzhen was expanded from 13 billion yuan to 52 billion yuan, and the investment quota of Hong Kong stocks was expanded from 10.5 billion yuan to 42 billion yuan, and it was enforced from May 1, 2018. Trading value under the stock connection between mainland China and Hong Kong reached 35,396.1 billion yuan in 2021 from 188.1 billion yuan in 2014. The second is the introduction of Shanghai and London Stock Connect. The related regulations were enforced from October 2018, and the global depository receipt (GDR) of Huatai Securities was listed in London on June 17, 2019. Then, in February 2022, based on Shanghai and London Stock Connect, the CSRC (1) added the Shenzhen Stock Exchange in China, (2) added Switzerland and Germany to the trading market abroad, and (3) allowed foreign issuers to raise funds in China. The Shanghai-Shenzhen Stock Exchange has also lowered the conditions for participation in the depository receipt business by private investors in mainland China from over 3 million yuan to over 500,000 yuan. Since then, from 2019 to 2020, Chinese financial authorities have proposed measures to simplify and improve the convenience of existing systems for investment in inward securities. First, on July 20, 2019, the State Council Financial Stability and Development Commission (established in 2017) announced measures consisting of 11 articles concerning the opening of money and money industries to the outside world. In the 11th, the point of “further improving the convenience of foreign institutional investors in the interbank bond market” was included. Then, on June 13 of the same year, President Yi Hui Mang of the CSRC, at the 11th Lujiazui Forum held in Shanghai, announced the measures consisting of 9 items concerning the opening of the securities industry to the outside world. Of the nine items, “Promote revisions to the QFII and RQFII systems and regulations to further enhance the convenience for foreign institutional investors to participate in the capital market of China,” was included in the first item, “consider expanding the outward opening of the exchange bond market and expand the channels through which foreign institutional investors invest in the exchange bond market” in the eighth item, and “Examine and enact management rules for panda bonds to be issued on exchanges, and further enhance the convenience of raising funds by issuing bonds of overseas institutions” in the ninth item. In response to these measures, the inward securities investment system was improved as follows. First, the system improvement on QFII and RQFII was carried out. Under the QFII system and the RQFII system, the upper limit of investment limit for individual institutional investment has been established until now, and on September 10, 2019, the State Administration of Foreign Exchange abolished the upper limit regulation. At the same time, on RQFII, the operational limit allocated to the market of each country and region in the world was also abolished. Subsequently, on May 7, 2020, the People’s Bank of China and the State Administration of Foreign Exchange announced that they would abolish the QFII and RQFII investment ceilings (unified to

“qualified investors”), unify foreign currency and yuan management, and shift to a registration system for deposit, withdrawal, and exchange. Next, on September 25, 2020, the CSRC, the People’s Bank of China, and the State Administration of Foreign Exchange promulgated the “Domestic Securities and Futures Investment Management Rules for QFII and RQFII” aimed at integrating the rules of QFII and RQFII, which had previously separately specified entry conditions and investment targets (enforced on November 1 of the same year).

### *IV-3. RMB Internationalization is Moving Again*

#### **IV-3-1. Opening of the RMB Internationalization Workshop (2019)**

On December 20, 2019, the People’s Bank of China held a “RMB Internationalization Workshop.” The following points were confirmed in the symposium. Since the testing of cross-border renminbi trading, RMB internationalization has maintained adaptation to market supply and demand, contributed to the real economy, promoted convenience of trade and investment, and promoted financial reform and innovation. After 10 years of development, the function of the renminbi as a unit of calculation (in international currency) became clear step by step, the function as a unit of payment was steadily strengthened, the function as a unit of investment and loan was constantly raised, the function as a unit of financial transaction was greatly improved, and the function as a reserve currency rose in a visible way.

The People’s Bank of China and the State Administration of Foreign Exchange, together with other relevant departments, will seriously and thoroughly implement the policy of “Steadily Promoting the Internationalization of the Renminbi” adopted at the 4th Plenary Session of the 19th Party Congress of the CPC, strengthen integration, coordination and international cooperation together with commercial banks and other financial institutions, increase the level and capacity of financial services, firmly focus on contributing to the real economy, focus on helping companies to reduce foreign exchange risk and to save exchange rate costs, increase financing channels, and further promote greater convenience for investment and trade.

#### **IV-3-2. Confirmation of RMB Internationalization in the 14th Five-Year Plan**

Based on the above discussion, the 14th Five-Year Plan (2021 to 2025) includes the following policies on the internationalization of the renminbi.

First, in the acceleration of the promotion of institutional opening (Chapter 40, Section 1), it is clearly stated to “Steadily promote the internationalization of the RMB and establish a new mutually beneficial partnership based on the free use of the renminbi by adhering to market leadership and voluntary choice of companies.” It is distinctive in that it seeks to promote the internationalization of the RMB by encouraging market participants’ incentives.

Second, the implementation of the Financial Security Strategy (Chapter 53, Section 3) clearly states to “strengthen the construction of a cross-border settlement system for the renminbi, enhance the security and controllability of key technologies for computerization in the financial industry, and maintain the security of the financial infrastructure.”

#### IV-3-3. Improving the cross-border bond investment regime

In order to promote the market-driven internationalization of the RMB, which is included in the 14th Five-Year Plan, the bond market has reviewed the method of opening to the outside world by dividing it into the exchange bond market and the interbank bond market, and has started to develop and improve a one-stop unified trading infrastructure for foreign investors.

Among the improvements, the first was the “Action Plan for the Construction of a High-Level Market System” promulgated by the Central Government Office of the People’s Republic of China and the State Council Office of the People’s Republic of China in January 2021, in which it was proposed to comprehensively plan the external opening of the interbank bond market and the exchange bond market, to optimize entry criteria and issue management, to clearly indicate the overall institutional framework for the external opening of the Chinese bond market, and to examine the establishment of the “Interim Bond Issue Management Law for Overseas Institutions in the Exchange Bond Market.” On December 2, 2022, the People’s Bank of China and the State Administration of Foreign Exchange promulgated the “Notice on Financial Management Matters of Bonds Issued by Overseas Institutions in Mainland China” on the issue market of panda bonds (Nonresident RMB bond). Although panda bonds are issued in the interbank bond market and the exchange bond market, based on the above notification, the application of the former “National Interbank Bond Market Overseas Institution Bond Issuance Management Provisional Bank Law” and the latter “Corporate Bond Issuance and Trading Management Bank Law” was eliminated, and the fund management rules such as fund registration, account opening, foreign currency exchange and use, and foreign exchange remittance in both markets were unified.

The second is the improvement of the system of the bond secondary market. On January 20, 2022, the Shanghai Stock Exchange and other organizations promulgated the “Interim Interconnection Service Law for the Interbank Bond Market and the Exchange Bond Market” (effective the same day), and institutional investors in the exchange bond market and members of the interbank bond market (including foreign banks) do not need to open accounts in each other’s markets and can trade in kind in the other market. Subsequently, on May 27 of the same year, the People’s Bank of China, the CSRC and the State Administration of Foreign Exchange jointly promulgated “Matters on Further Convenience of Investment in the Chinese Bond Market by Foreign Institutional Investors”. In this matter promulgated, the external opening of interbank and exchange bond markets is promoted simultaneously, and overseas institutional investors who invest in interbank bond markets can voluntarily choose custody services provided by bond registration clearing organizations and custodian banks.

#### IV-3-4. Strengthening Cooperation with the Hong Kong Market

In relation to the Hong Kong market, “Help Hong Kong to enhance its position as an international financial, air and maritime transport, trade centre and international airport hub. Enhance Hong Kong’s ability to function as a hub for global offshore renminbi operations

and an international asset management center and risk management center,” is clearly stated in the support for securing and improving the competitive advantage of Hong Kong and Macao (Chapter 61, Section 1). Since 2021, three new initiatives have been launched to promote the internationalization of the renminbi in cooperation with the Hong Kong market. The first is an experiment of “Cross-boundary Wealth Management Connect (WMC),” a mutual sales system of asset management products for individual investors, between Guangdong Province and Hong Kong and Macao on October 19, 2021. This is also the first attempt to establish a cross-border securities investment system in about four years, following Stock Connect, which has already been launched between mainland China and Hong Kong. The WMC consists of “Southbound” in which mainland Chinese residents in Guangdong Province and Hong Kong and Macao open investment accounts at banks in Hong Kong and Macao and purchase qualified investment products sold by banks in Hong Kong and Macao; and “Northbound” in which residents in Hong Kong and Macao open investment accounts at banks in mainland China in Guangdong Province, Hong Kong and Macao and purchase property products sold by banks in mainland China. For both bounds, the total net inflow is set at 150 billion yuan and the net purchase amount per individual investor is set at 100,000 yuan, respectively. In the Greater Bay Area plan of Guangdong Province, Hong Kong and Macao, the purpose of the WMC is to improve the convenience of the cross-border investment of the investor.

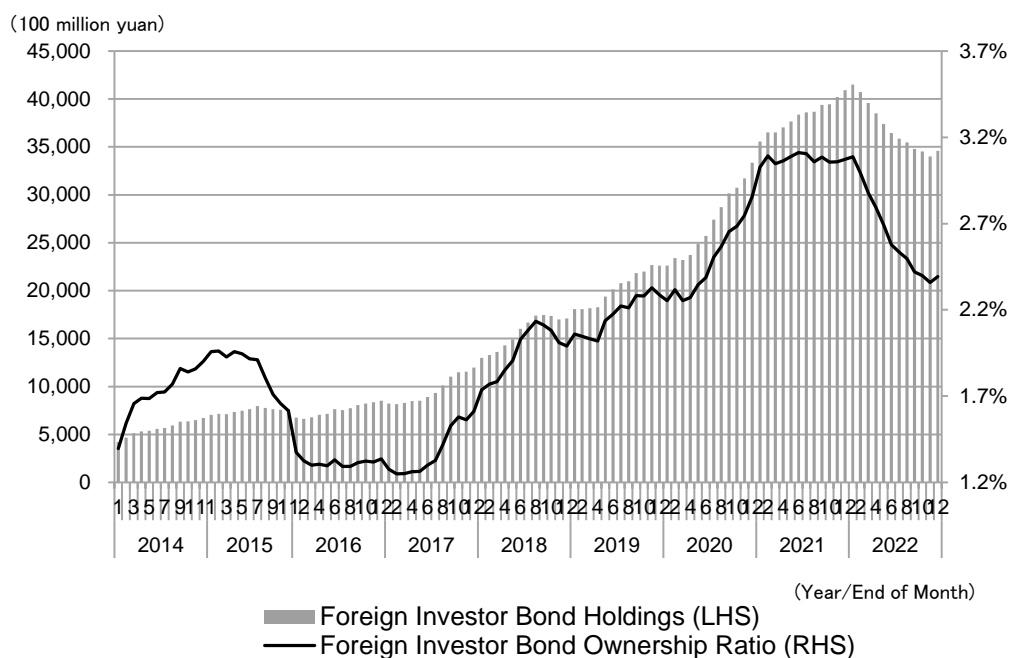
The second was the southbound Bond Connect, which had not yet been realized through mutual bond investment between mainland China and Hong Kong, which started on September 24, 2021.

It opens up a new channel for international diversification in the eyes of mainland Chinese investors. Bearing in mind the expansion of financial transactions between mainland China and Hong Kong, such as WMC and Bond Connect (Southbound), the People’s Bank of China extended the swap agreement with the HKMA for 5 years on November 25, 2020, the year before the two regimes were launched, and at the same time the withdrawal limits were 500 billion yuan for the HKMA and 590 billion Hong Kong dollars for the PBOC, up from 400 billion yuan and 470 billion Hong Kong dollars previously.

The third is the two new Connects established on the occasion of the 25 year anniversary of Hong Kong’s return to mainland China (July 1, 2022). The first is “ETF Connect” which is a mutual trading system between mainland China and Exchange Traded Funds (ETF) in Hong Kong. ETF Connect allows Hong Kong qualified investors and brokers to buy and sell 83 mainland-listed ETFs and mainland Chinese investors to buy and sell 4 Hong Kong-listed ETFs. It started on July 4 of the same year. The second is “Swap Connect” which is a mutual trading system of derivatives (financial derivatives) announced on July 4 of the same year. Northbound, which allows Hong Kong to trade interest rate swaps in mainland China, launched on May 15, 2023. Although bond trading routes in mainland China are expanding and diversifying through QFII, RQFII, CIBM Direct, and Bond Connect (Northbound) to foreign investors, unlike overseas government-affiliated institutional investors, investment in products that hedge cash transactions remains limited. The 14th Five-Year Plan for the

construction of the Shanghai International Financial Center sets a target to increase the ratio of foreign investors' holdings in the outstanding amount of bonds in the Shanghai bond market from 3% in 2020 to around 5% in 2025 (Figure 7). It can be said that the city government expects that the start of Swap Connect will also contribute to achieving this goal. With the launch of the new Connect in July 2022, the renminbi currency swap amount between the People's Bank of China and the HKMA has been further increased to 800 billion yuan (H.K. \$940 billion equivalent).

Figure 7: Bond holding trends of foreign investors in the Chinese mainland bond market



Note: As the amount of foreign investors' bonds held in December, 2015 was not disclosed, the amount held in December, 2015 was not available.

Source: Nomura Institute of Capital Markets Research, based on the People's Bank of China

#### IV-4. Internationalization of the RMB as an economic stimulus measure (2022)

As the outbreak of the COVID-19 pandemic has continued worldwide since the beginning of 2020, China strengthened its anti-infection measures (the so-called “zero-coronavirus policy”) in 2022 to reduce the number of new infections in the community to zero. In order to ensure social distancing, measures were taken to restrict the flow of people such as the lockdown of the area where the infection of the person occurred, isolation to avoid close contact, recommendation and guidance of teleworking outside the lockdown area, restriction and suspension of the operation of public transportation, prohibition of eating and drinking in the store, closure of schools and remote classes. Though the human flow restriction mea-

asures have been gradually lifted from the region where the infection prevention measures were effective, both the central government and the local government have prepared and carried out the economic countermeasure for getting out from the stagnation of production and consumption.

On April 18, 2022, the People's Bank of China and the State Administration of Foreign Exchange promulgated the "Notice on the Steady Implementation of Financial Assistance for the Prevention of Novel Coronavirus Infection and Economic and Social Development," which comprises a total of 23 articles. The notice also includes information that could lead to the internationalization of the RMB in terms of export support for companies, foreign exchange risk hedging support, and overseas financing.

(Article 16) Raise the level of trade convenience

- Spread the policy of convenience of trade and foreign exchange balance of good enterprises across the country, steadily implement the test of convenience of renminbi settlement of trade and investment at a higher level, and encourage banks to incorporate more good SMEs into the scope of convenience policy.

(Article 18) Develop services for the management of foreign exchange risk of enterprises

- Financial institutions must respond to the foreign exchange risk hedging needs of market entities such as foreign trading enterprises in a timely manner, support the expansion of renminbi cross-border settlement by enterprises, optimize the management and services of foreign exchange derivative products business, and reduce the cost of risk hedging and value maintenance by enterprises.

(Article 21) Improving the convenience of cross-border investment and financing by investors

- Promote the unification of the criteria for entry into interbank and exchange bond markets, simplify entry procedures, and improve the cash management of foreign investors' investment in China's domestic bond markets.
- Optimize the fund management of bonds issued in China by overseas institutions, and make it possible for related companies in China that are issuing entities of panda bonds to borrow funds to issue panda bonds in response to actual demand.
- Further facilitate the registration of securities futures investment funds in China by QFII and RQFII.

In connection with this Article 23 Notice, on June 20, 2022, the People's Bank of China issued the "Notice to Support Transboundary Renminbi Settlement in New Foreign Trade Business." The notice is characterized by the acceptance and recommendation of trade settlement in renminbi not only through commercial banks but also through non-bank settlement institutions and clearing organizations with Internet settlement business licenses, and the promotion of trade by individuals and microenterprises.

In addition, in the Shanghai Securities Journal dated April 28, 2022, the challenge of the convenience improvement test on cross-border RMB settlement in Shenzhen City is introduced. In June 2020, under the FTZ of Guangdong Province, the geographical scope of this test for cross-border RMB settlement was expanded from the Qianhai Shekou area to the whole Shenzhen city, and it was shifted from "pre-screening" for each settlement to

“post-sample inspection” for good, designated enterprises. Under the preliminary examination, in the case of external payments, it was necessary to submit a large number of documents such as remittance applications, contracts or receipts, and customs declaration documents, and to confirm the contents of each major transaction. However, since the post-examination, the business process has been greatly simplified, and the business processing time has been reduced to 1/3 on average. As of March 31, 2022, 18 banks and 643 enterprises in Shenzhen City participated, and the cumulative test value was 166.93 billion yuan. The central bank of Shenzhen City of the People’s Bank of China and the Shenzhen Branch Bureau of the State Administration of Foreign Exchange intend to further expand the test range, reduce exchange rate risk of small and medium enterprises, and establish the settlement of renminbi in foreign trade. “More companies can enjoy the convenience of policy if they are only required to prove their credit and comply with the law,” said an official of the International Affairs Department of the Shenzhen Branch of China Construction Bank. In light of the Article 23 notification, it will also be interesting to see how the testing of cross-border renminbi payments in Shenzhen will be further eased.

As a result of the promotion of RMB internationalization as an economic stimulus, the amount of RMB denominated trade in 2022 reached a record high of 10.51 trillion yuan for the entire year, and the ratio of RMB denominated settlement to total trade amounted to 25.0% (Figure 3 above).

#### *IV-5. Promoting RMB Internationalization in the Framework of Economic Partnership Agreements*

The Regional Comprehensive Economic Partnership (RCEP) Agreement, in which 15 countries including Japan and China participate, entered into force in 10 countries on January 1, 2022. The RCEP Agreement is a large-scale agreement in a region that accounts for about 30% of the world’s GDP, total trade, and population. In China, the Standing Council of the State Council held on December 23, 2021, decided on a policy for steady implementation of the RCEP Agreement in order to promote further development of trade and investment in China and upgrading of domestic industries. In response to this policy, on January 26, 2022, the Ministry of Commerce, the People’s Bank of China, and six other divisions issued “Guidance Opinions on the Implementation of High-Quality RCEP.” On the financial side, they stated that they would “enhance support functions for the expansion of trade and investment through renminbi settlement,” and the People’s Bank of China took charge of the following directions.

- Promote the further use of RMB settlement in trade and investment activities in the RCEP area to help market participants reduce exchange costs and avoid exchange rate fluctuation risks.
- Continue to optimize policies and infrastructure construction to provide a favorable institutional environment for cross-border use of the renminbi.
- To provide convenient and efficient cross-border renminbi denominated financial products and services to market participants by instructing financial institutions to raise the

level of financial services and supporting financial institutions to trade, invest in renminbi and innovate risk hedging products.

## V. Digital Yuan Demonstration and International Settlement

### *V-1. Research and development of digital yuan in parallel with renminbi internationalization*

In China, the Beijing Winter Olympics was held from February 4 to 20, 2022, while the COVID-19 pandemic continues worldwide. Subsequently, the Paralympics were held from March 4 to 13 of the same year. This time, the venues of these two tournaments, which are held once every four years, were set up in the capital city of Beijing and the surrounding Hebei Province (Zhangjiakou City) in China, and it became a topic that the venues and the facilities where athletes and tournament officials stayed were managed by the bubble system in order to prevent COVID-19. At the same time, it also became a topic of conversation that, in addition to credit cards, digital yuan (e-CNY) payment experiments were conducted for purchases and meals in the bubble.

The digital yuan is a CBDC issued by the People's Bank of China. The digital yuan can be used in the same way as cash (coins and bills) by downloading a special application to a smartphone, etc., and charging the required amount. The Bank established a dedicated research team on digital currency within the Bank in 2014 and established the Digital Currency Research Institute in Shenzhen City in January 2017. After ratification by the State Council at the end of the same year, the Bank started experiments on research and development of digital yuan jointly with commercial banks. Subsequently, in June 2018, the Digital Currency Research Institute of the Bank established "Shenzhen Financial Technology Co., Ltd." in Shenzhen City to conduct experiments on FinTech, and has been promoting research and development of digital currencies. Since 2020, a demonstration experiment using digital yuan in the market has been carried out.

Some central banks in the world already have plans to issue CBDCs or have started demonstration experiments in the community. In developed countries, for example, the central bank of Sweden launched a project in November 2016 to issue e-krona as a payment settlement instrument to complement krona. In the emerging countries, the central bank of Cambodia started the pilot test of "Bakong" as CBDC from December 2019, and introduced it in the community from October 2020. In particular, China, as the world's second largest economy, can be said to be ahead of the world's central banks in research and development of CBDCs and in the scale of demonstration experiments involving social implementation of issuance and distribution.



## V-2. *Introduction of the Digital Yuan: Libra Initiative and Accelerated by the COVID-19 Pandemic*

### V-2-1. Impact of the Libra Initiative on China

On July 8, 2019, Wang Xin, Director General of the Research Bureau of the People's Bank of China, announced at a meeting of academic research in China that the State Council had already approved research on the issuance of digital currencies by the central bank. This was the first time that the Bank officially announced the existence of a plan to issue a digital yuan, albeit for domestic use.

Behind the announcement by the People's Bank of China of its plan to issue a digital currency was an alarm over the Libra (now Diem) initiative proposed by Facebook (now Meta) of the United States. The Libra concept is the plan announced by the company on June 18, 2019, to issue digital currency as "Crypto Assets" to be traded on the Internet (issuance was abandoned at the end of January 2022). The conventional digital currency is Bitcoin, but Bitcoin has a problem that it is unstable to be used as a payment method because there is no organization to manage it such as a central bank, and because it is issued without the backing of assets such as currencies of various countries, the price fluctuates wildly. Libra, on the other hand, was designed to be managed by the "Libra Association," which is funded by global companies, and to issue digital currencies (so-called stablecoins) linked to the value of the U.S. dollar, the euro, and national government bonds of each country.

However, the financial authorities of various countries in the world expressed their concern about this Libra concept. Wang Xin, Director General of the Research Bureau of the People's Bank of China, also expressed the following views on the Libra Initiative at the aforementioned academic workshop. First, it is difficult to replace the function of the original currency because of the price fluctuation of Bitcoin, but Libra has the possibility to function as a currency. Second, the Libra Initiative may therefore have an important impact on monetary policy, financial stability, and the international financial system in countries around the world. This is because in the background of currency there are profit, power, international politics, and diplomacy, and if one means of payment has the same function as currency, competition with fiat currency will occur. Third, as a challenge to Libra, there is a way for the central bank to issue digital currency in a hurry. China must raise its voice on China promptly, while promoting international cooperation and cooperation.

Subsequently, on August 18, 2019, the Central and State Councils of the CPC jointly announced "Opinion on the construction of a socialist leading model district with Chinese characteristics in Shenzhen City," and in the same opinion, "Support for research on digital currency and innovative applications such as mobile payment in Shenzhen City." In 2020, the 40 year anniversary of the designation of Shenzhen City as a special economic zone in 1980, the Central Office of the CPC and the State Council Office of the CPC jointly announced "Comprehensive Reform Test Implementation Plan for the Construction of a Socialist Preceding Model Zone with Chinese Characteristics in Shenzhen (2020-2025)" on

October 11, and “Supporting the implementation of the internal close test of the digital yuan and promoting R&D and application of the digital yuan and international cooperation” was specified in the same opinion, leading to the demonstration experiment of digital yuan in Shenzhen City for the first time in China.

### V-2-2. Impact of the COVID-19 pandemic

The demonstration experiment of the digital yuan became concrete in 2020. In the background, there is also the effect of the COVID-19 pandemic. In China, quarantine and disinfection of cash have been strengthened because the virus can be a source of infection to the human body if it adheres to cash (coins and banknotes) in the process of the rapid spread of infection since the first mass infection of the COVID-19 pandemic was confirmed in Wuhan City, Hubei Province, in December 2019. On the other hand, mobile payments such as Alipay and WeChat Pay, which do not need to touch cash directly, were recommended.

On April 3, 2020, the People’s Bank of China held the National Coinage, Gold, and Silver Security Work Conference in 2020, and mentioned the research and development of digital yuan as the work to strengthen the top-down promotion in the same year. From the viewpoint of epidemic prevention measures, the digital yuan was emphasized as a settlement means without having to touch cash directly.

### V-3. *The System Design of Digital Yuan*

On July 16, 2021, the People’s Bank of China released for the first time a document entitled “White paper on the progress of research and development of e-CNY in China” (below is the white paper). According to the white paper, by the end of June of the same year, the issuance and distribution of digital yuan was experimented in 1.32 million places such as restaurants and transportation, and the experiment amount was 34.5 billion yuan, and the cumulative number of transactions of individuals (20.87 million accounts) and corporation (3.51 million accounts) reached 70.75 million.

In addition to the white paper, the People’s Bank of China’s governor Yi Gang (at that time, Pan Gongsheng is now president) explained the outline of the digital yuan in his lecture on November 9 of the same year. The system design of the digital yuan which can be confirmed from the white paper and lecture is as follows.

#### V-3-1. The position of Statutory Currency

The white paper defines the digital yuan as “legal tender issued by the People’s Bank of China in data format.”

Though the demonstration experiment limited to the region in China precedes, one of the problems for the formal issuance of the digital yuan is law improvement. On October 23, 2020, the People’s Bank of China announced the revision of the “PBOC Law” corresponding to the Central Bank Law, and invited public comments until November 23 of the same year. In the proposal, it stated that “the legal currency of the People’s Republic of China is the ren-

minbi” (Article 18) and that “the renminbi consists of real form and data form” (Article 19), providing a legal basis for the issuance of CBDC.

It also stated that “the People’s Bank of China will manufacture and issue the renminbi in a unified manner” (Article 20), “No organization or individual may manufacture or issue digital currency” (Article 22), clarifying that only the People’s Bank of China as the central bank will issue the digital yuan as legal tender and eliminating the scope for issuance by private entities. The Bank is strengthening measures to prohibit the issuance and distribution of crypto assets, including Bitcoin, in mainland China while proceeding with the demonstration test of the digital yuan.

After the revision of the law, the People’s Bank of China is expected to proceed with the elaboration of detailed regulations for the issuance and distribution of digital yuan based on the results of the demonstration experiment in the city.

### V-3-2. Adoption of a two-tier management system

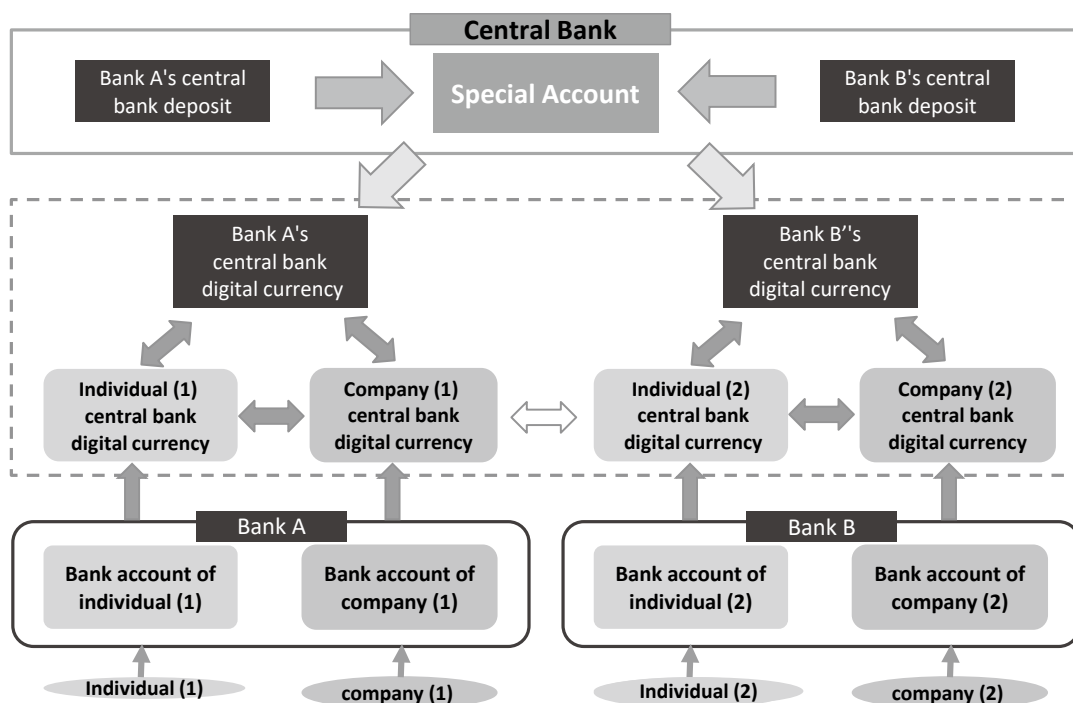
China constructed the prototype of CBDC as China in 2016 by the following approach. First, the digital yuan replaces the M0 (cash currency), and its function is exactly the same as that of cash (coins and bills), and it bears no interest and reduces competition with bank deposits.

Second, the People’s Bank of China will exchange digital yuan with commercial banks or other payment institutions, and these institutions will act as intermediaries with users to provide digital yuan exchange and payment services. CBDCs can be issued in a variety of ways: (1) directly to users by the central bank (direct type) or indirectly through commercial banks (indirect type); (2) using a central bank account to issue a central bank digital currency (account type) or in a form that allows exchange between users without using a central bank account (token type). From the above comment of the People’s Bank of China, it seems that what China assumes is the indirect type and the form which enables the exchange between users. Professor Shuji Kobayakawa of Meiji University calls this “indirect issuance and value preservation type scheme” (Figure 8). Third, we will set a cap on the balance of wallets and transaction amounts on smartphones and other devices that charge digital yuan in order to minimize institutional friction and risk of bank runs.

### V-3-3. Managed Anonymity

Regarding the anonymity of the digital yuan, based on the principle of “Small volumes anonymous; large volumes traceable to law” and regarding the collection of personal information, based on the principle of “minimal, necessary” the amount of information to be collected should be less than that of current electronic payment tools. At the same time, the storage and use of personal information are strictly controlled, and the People’s Bank of China cannot provide relevant information to third parties or government agencies unless there is a clear legal requirement. The “Data Security Act” and “Personal Information Protection Act” strengthen data security and privacy protection from the legislative side.

Figure 8: Central Bank Digital Currency: Indirect Issuance and Value Preserving Scheme



Source: Nomura Institute of Capital Markets Research, based on Shuji Kobayakawa (2019), "A Study on Central Bank Digital Currency — Concrete Design and Implications —," *Meiji University Institute of Political Economy*, volume 87, 3-4

#### V-3-4. Applications

The design and application of the digital yuan is mainly to meet the domestic settlement demand in retail. As long as there is a demand for cash, the People's Bank of China will not stop the supply of cash or facilitate the exchange by executive order.

In addition, cross-border use of the digital yuan and international settlement are relatively complicated, and legal issues such as anti-money laundering and identification (Know Your Customer) must be addressed.

#### V-4. Trends in Digital Yuan Demonstration Test

##### V-4-1. Specifying "4 Regions +1 Scene" (2019 - 2020)

On March 1, 2019, the People's Bank of China's Institute of Digital Currency established "Long Triangle Financial Technology Co., Ltd." as a new FinTech subsidiary in Suzhou City (Jiangsu Province), in addition to the decision of the demonstration test of digital yuan in Shenzhen City in August 2019 and October 2020.

On April 18, 2020, the Institute of Digital Currency of the People's Bank of China announced that in addition to Shenzhen City and Suzhou City, closed demonstration experiments will be conducted in Hebei Province and Xiongan New District, which President Xi

Jinping established as a base for innovation, in Sichuan Province and Chengdu City, which are base cities in the interior, and in scenes related to the 2022 Beijing Winter Olympics.

Subsequently, in October 2020, in Shenzhen City, a demonstration experiment of digital yuan was carried out in which a total of 50,000 persons (10 million yuan in total), 200 yuan per person, were distributed by lottery system. It was the first public experiment in China. Next, in December 2020, the second domestic open experiment was also carried out in Suzhou City, Jiangsu Province, in conjunction with the offline sales on December 12. In the experiment in Suzhou City, (1) the experiment was carried out not only in the offline physical store but also in the online mall (Keitong Shoko), and (2) the experiment was carried out on the transfer function of the digital yuan in the condition without the portable telephone network.

#### V-4-2. Expansion of the demonstration test area (2020)

On April 12, 2021, Li Bin, Director General of the Macroprudential Administration Bureau of the People's Bank of China, announced that in addition to the above "4 regions +1 scene" designated as experimental areas at the end of 2019, 6 regions were designated in October 2020: Shanghai City, Hainan Province, Changsha City (Hunan Province), Xi'an City (Shaanxi Province), Qingdao City (Shandong Province) and Dalian City (Liaoning Province), and the experiment was started in November of the same year.

Then, according to the China Securities Journal of January 4, 2022, a trial wallet application for managing the digital yuan with a smartphone started to be distributed on the 4th. The app can be downloaded for iPhone or Chinese Android by residents of 10 regions including Shanghai and the Beijing Winter Olympics (10 regions plus 1 scene).

#### V-4-3. Demonstration Test at the Beijing Winter Olympics (February to March 2022)

##### (1) Two types of charging methods

In the demonstration experiment in the bubble of the Beijing Winter Olympics, two kinds of charging methods were adopted. In both methods, users can choose arbitrarily.

##### A: Soft Wallet Method

The first is a soft wallet called "soft coin bag" in Chinese, which is a method to download and charge a digital yuan application to a mobile phone. If someone from overseas is using an iPhone, they get an Apple ID from mainland China and download the digital yuan app from the App Store. If Android is the mobile phone number of the operating system, the digital yuan application is downloaded from the QR code provided by the Bank of China (which is the official banking cooperation partner in the Beijing Winter Olympics and Paralympics).

When opening a soft wallet, it is not necessary to link it with a bank account in mainland China, and if it is daily small consumption, the wallet can be set from any operating organization.

#### B: Hard wallet method

The second is a hard wallet called “hard Qian Bao” in Chinese, and there are cards and bracelet types. When foreign currencies are inserted into a dedicated digital yuan automatic exchange, they are exchanged and charged to the hard wallet.

#### (2) Results of the demonstration test

In addition, RMB cash (including banknotes) and VISA cards could be used in the bubble, but third-party payments such as Alipay and WeChat Pay could not be used. On February 10, 2022, Wang, Deputy Director of the Beijing Municipal Bureau of Financial Supervision, said that the demonstration of the digital yuan at the Beijing Winter Olympics exceeded 400,000 and the transaction value reached 9.6 billion yuan.

#### V-4-4. Expansion of the demonstration test area (2022)

On March 31, 2022, the People’s Bank of China held a roundtable discussion on experimental work on R&D of digital yuan, and designated 6 regions of Tianjin City, Chongqing City, Guangzhou City of Guangdong Province, Fuzhou City and Xiamen City of Fujian Province, and Zhejiang Province (the 2022 Asian Games (September 10 to 25) will be postponed to May 6) as demonstration test areas. At the same time, the digital yuan test scenes at the Beijing Winter Olympics and Paralympics held in Beijing City and Zhangjiakou City in Hebei Province from February to March of the same year were converted into demonstration test areas. Recently, it was also noticed that since June 2022, as a part of domestic economic stimulus measures, an attempt has been made to distribute consumption discount coupons in digital yuan format in some experimental areas.

#### V-4-5. Future Initiatives Based on Demonstration Experiments

The People’s Bank of China intends to make the following improvements based on the experimental status of the digital yuan so far.

First, referring to the concept of cash and bank account management, we construct a management model suitable for digital yuan. Second, we will improve the efficiency of settlement of digital yuan, privacy protection, forgery prevention, and other functions. Third, we will promote interactivity (two-way connection) between the digital yuan and existing electronic payment tools. Fourth, we will improve the ecosystem (increase and diversification of usage scenes) related to digital yuan.

#### V-5. *Research Trends for Digital Yuan Cross-border Payments*

##### V-5-1. Preparation for international settlement (establishment of joint venture with SWIFT)

According to Reuters on February 3, 2021, SWIFT established a joint venture with the People’s Bank of China’s Institute of Digital Currency on January 16. The name is “Finance Gateway Information Services Company,” and the registered capital is 10 million euro, and

SWIFT has 55% investment and the People's Bank of China has 45% investment.

The legal representative is Mr. Huang Meilin (President of SWIFT China Region), and the chairperson is Mr. Cheng Zhengang (at that time, Yang Wen, Deputy Secretary General of the China Clearing and Settlement Association, is now president). Of the four directors, three are appointed by SWIFT and one is appointed by Mr. Mu Changchun, President of the Institute of Digital Currency of the People's Bank of China. Management ranges are integration of information systems, data processing, and technical consulting.

On the international settlement of RMB, CIPS has been in operation since 2015, and the system design and transactions are carried out on the premise of the connection with SWIFT. Research on international payment of digital yuan through the interconnection of SWIFT and CIPS may also be included in the scope of management of the joint venture.

#### V-5-2. Multilateral Initiatives

On February 24, 2021, the People's Bank of China announced the launch of a joint study on CBDC with the central banks of Hong Kong, Thailand and the United Arab Emirates (UAE) (m-CBDC Bridge). This research aims at developing a prototype for realizing multi-currency simultaneous settlement of CBDC based on distributed ledger technology (DLT) and enhancing convenience of foreign exchange transactions in international trade. It is supported by the Hong Kong Innovation Hub of the BIS. On October 26, 2022, the BIS announced that the four aforementioned central banks had conducted 164 cross-border payments and foreign exchange transactions totaling more than \$22 million using the m-CBDC Bridge platform and that the first experiment had ended.

In the report published in March 2021, the BIS organizes the framework for utilizing CBDC issued for the home country in the cross-border settlement into three patterns. The first is to standardize data, technology, interfaces, regulations, and supervision after issuing CBDC. It is a model of international joint research in which the Bank of Japan and others participate. The second is that each issues a CBDC, but the technology and settlement system are common. There are joint projects between the Financial Services Agency of Singapore and the Bank of Canada. The third is for the concerned countries to integrate the CBDC system, and to construct a multilateral settlement platform by the CBDC. This applies to the m-CBDC Bridge described above.

#### V-5-3. Experiments in settlement with Hong Kong

On March 30, 2021, in cooperation with the Luohu District Government of Shenzhen City, the Bank of China, and the Bank of China (Hong Kong), Hong Kong residents experimented with the use of digital yuan in mainland China. Among Hong Kong residents, (1) Hong Kong residents who frequently visit Shenzhen and have a pass to the mainland (authentication by real name registration using a pass), and (2) Hong Kong residents who occasionally visit Shenzhen and do not have a pass to the mainland (telephone number registration is mandatory but anonymous) are eligible. The digital yuan application was downloaded to a mobile phone used in Hong Kong, and the payment for small consumption and mer-

chandise purchase was experimented through a POS device by showing a QR code. Hong Kong residents can open 5 types of wallets based on the strength of their real name information and can use up to 50,000 yuan per payment if they upgrade to a “Type 2” wallet linked to a Bank of China card.

Subsequently, on June 8, 2021, the HKMA announced the “Financial Science and Technology 2025” strategy. The strategy specified that (1) in cooperation with the BIS Hong Kong Innovation Hub, we will start research on digital Hong Kong dollars (e-HKD) for retail, and (2) in cooperation with the People’s Bank of China, we will conduct technical tests in Hong Kong on the use of digital yuan (e-CNY) to provide convenient cross-border payment services for residents of Hong Kong and mainland China.

According to the China Securities Journal, dated December 9, 2021, Mu Changchun, Director of the Institute of Digital Currency at the People’s Bank of China, explained in a forum titled “The Role and Prospects of the Hong Kong International Financial Center” that in the cooperation project between the Institute of Digital Currency at the Bank and the HKMA, the first phase of technical testing, namely, the development of the functions of the Mainland Bank of China in Hong Kong to charge, transfer and consume digital yuan into wallets with designated stores in Hong Kong, had been completed. At present, the second stage test (connecting the Digital Yuan System to Hong Kong’s Faster Payment System (FPS allows instant settlement in Hong Kong dollars or yuan)) is being developed.

## **VI. Future Prospects for RMB Internationalization**

### *VI-1. Place of the RMB in the International Monetary System in the 21st Century (Image)*

In China’s 14th Five-Year Plan (2021 to 2025) and related documents, China has set its role and objectives in the international monetary system as follows.

- First, we will continue to actively participate in global economic and financial governance to maintain global economic and financial stability. Promote deepening governance reforms at key multilateral financial institutions, promote further improvements in equity ownership and governance structures at the IMF and the World Bank, enhance China’s voice and representation, and consolidate China’s institutional rights.
- Second, it will demonstrate its international economic cooperation functions, such as the promotion of the Group of 20 (Summit on Finance and the World Economy), participate constructively in institutional economic governance cooperation such as APEC (Asia-Pacific Economic Cooperation) and BRICS (Brazil, Russia, India, China, South Africa), and propose more China initiatives and China solutions. Promote the deepening of governance reforms at key multilateral financial institutions, support the better functioning of the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB), and enhance and participate in the governance capacity of international finance. In particular, China will take the opportunity of hosting the 14th BRICS



Summit in 2022 to promote the deepening of the strategic partnership among BRICS countries, further echo the voice of BRICS in important international and regional issues, and expand the “Three Drives” and “BRICS +” cooperation in economic, trade, fiscal and financial affairs, political security and humanities exchange.

- Third, cooperation with major economic entities will be strengthened through bilateral dialogue mechanisms. In the bilateral relationship, Sino-Russian relations will deepen the full strategic partnership of the new era and make China-Russia a pillar for global peace and security and global strategic stability, while U.S.-Chinese relations will promote a return to reason in U.S. policy toward China and place U.S.-Chinese relations within a strategic framework for sound and stable development.

## *VI-2. Positioning the RMB in Regional Financial Cooperation*

Among regional financial cooperation, the Beijing Declaration at the 14th BRICS Summit held in Beijing from June 23 to 24, 2022, states that financial cooperation among member countries will be promoted as follows, assuming cooperation with the IMF.

- First, BRICS reiterates its support for a strong and effective global financial safety network based on quotas and led by the well-resourced IMF. BRICS calls for the completion of the 16 General Review of Quotas on schedule by December 15, 2023, to reduce the IMF’s reliance on temporary resources, to address the lack of representation of emerging markets and developing countries, to participate effectively in IMF governance, and to protect the voice and quotas of the poorest and weakest countries. BRICS welcomes external resource-rich countries to provide assistance to countries in need through the lending of SDR and welcomes the decision to establish the IMF Resilience and Sustainability Trust (RST) and looks forward to its immediate operation.
- Second, BRICS recognizes the importance of the Emergency Foreign Exchange Reserve Interoperability Scheme (Contingent Reserve Arrangement, CRA, \$100 billion), which helps to strengthen global financial safety networks and complement existing international monetary and financial systems. BRICS supports the amendments to the CRA and welcomes progress in amending other relevant regulations relating to the CRA. BRICS will help establish a cooperative framework between the CRA and the IMF. As part of the post-streamlined CRA review exercise, BRICS welcomes the 5 national central banks to jointly complete the 2022 BRICS Economic Report.

## *VI-3. Digital Yuan International Payments*

As for the digital yuan, the 14th Five-Year Plan clearly states in “Promoting Financial Supply-Side Structural Reform” (Chapter 21, Section 3) that “Research and development of digital currencies will be promoted in stages.” The People’s Bank of China says it will use the digital yuan for domestic payments in retail for the time being, and that it will not announce a specific issuance schedule without setting one in advance.

At the same time, regarding the international settlement of the digital yuan, the policy states, “Promote the establishment of economic governance rules in emerging fields. Specifically, it will strengthen digital currency governance cooperation and actively participate in the establishment of global digital currency compliance, legislation, and management and supervision regulations.” Regarding the international settlement of the digital yuan, the People’s Bank of China explains that it assumes respect for the monetary sovereignty of both countries, compliance with the laws and regulations of the countries concerned, and establishment of a cooperative mechanism for exchange transactions and management and supervision of the CBDC. Based on the R&D trends and technical cooperation of CBDCs around the world, the Bank will consider the international settlement method of the digital yuan from a long-term perspective. The main premise will be to resolve the three trilemmas (free capital flows, fixed exchange rates, and independent monetary policy) in the renminbi internationalization strategy.

Regarding the international settlement of the digital yuan, Zhou Xiaochuan, former governor of the People’s Bank of China, made the following statement (Securities Times, April 22, 2021).

- At the Boao Asia Forum, the internationalization of the RMB and the cross-border diffusion and use of the digital yuan have attracted domestic and international interest, such as “Is there a relationship between the digital yuan and RMB internationalization efforts” and “Will the digital yuan be used in the future in the development of the Belt and Road Initiative.”
- “The potential of the digital yuan for cross-border payments in the future is not only a question of one side, but it should be seen whether the share of renminbi usage increases in the process of RMB internationalization. If renminbi usage increases, the use of digital yuan will naturally increase.” Zhou Xiaochuan told the media on April 21, 2021. “What needs to be done now is to gradually increase the credit and free use of the renminbi, and at the same time improve infrastructure such as cross-border payment systems.”
- “The internationalization of the RMB is influenced by the Chinese economy, and the stability, convertibility, and practicality of the renminbi, and whether investment in renminbi positions leads to normal deposits and retention and expansion of value are generally taken into consideration as the Chinese economy continues to grow,” it said, adding, “In any case, whether the renminbi will become an option as an international currency will be gradually advanced and will be decided voluntarily by market entities.”

#### *VI-4. Immediate Issues in Promoting RMB Internationalization*

On the internationalization of the RMB, while the Chinese government is drawing the medium- and long-term prospect by the five-year plan, etc., how to cope with the change to the immediate market environment also becomes a problem.

The first problem is the change of the external market environment around China which made the armed invasion to Ukraine by the Russian army on February 24, 2022, to be an opportunity. Since the invasion, financial sanctions have been imposed to remove major Russian banks from SWIFT, particularly in the West, but Beijing has said it will maintain normal trade and economic ties with Russia. Since the annexation of Crimea by Russia in March 2014, China and Russia have been promoting the conclusion of renminbi currency swap agreements between central banks, the designation of the RMB Clearing Bank in Russia (a Russian subsidiary of the Industrial and Commercial Bank of China), cooperation between central bank payment systems, and cooperation in the bond market. In order to maintain economic and trade relations with Russia, opportunities have arrived to expand renminbi payments through the new participation of Russian banks in CIPS. In fact, when looking at the international settlement share of the renminbi outside mainland China, which SWIFT examined, Russia rose from 0.62% in April 2022 to 4.27% in August of the same year, following Hong Kong (71.14%) and the United Kingdom (5.75%). On the other hand, progress in financial cooperation between China and Russia under the new international situation is accompanied by the risk that Chinese financial institutions and companies will be subject to secondary sanctions from the United States and Europe. Therefore, the Chinese authorities may consider the possibility of proceeding with the peace negotiations over Ukraine while keeping an eye on them.

The second issue is how the financial authorities will respond to changes in sentiment among participants in the securities and foreign exchange markets due to the “zero-coronavirus policy” of the past three years and the reopening of the economy in December 2022. In 2022, there was concern about the impact of the social zero policy aimed at zero community-acquired infections on the stagnation of economic activity, and the amount of stock held by foreign investors decreased from 3,942 billion yuan at the end of December 2021 to 2,768 billion yuan at the end of October 2022 (Figure 5 above). Similarly, bond holdings decreased from 4,151.7 billion yuan (3.09% of total bond market holdings) at the end of January 2022 to 3,401.1 billion yuan (2.36%) at the end of November 2022 (Figure 7 above). During this period, in the context of strengthening cooperation with the Hong Kong market and RMB internationalization, the supervisory board on September 2, 2022, (1) expanded the target stocks of stock connect between mainland China and Hong Kong, and promoted Hong Kong to target foreign companies with major listing destinations and more listed companies in the Shanghai and Shenzhen markets, (2) built a platform for renminbi stock trading in Hong Kong and supported RMB internationalization, and (3) considered the introduction of government bond futures in Hong Kong and promoted the opening of the government bond futures market both inward and outward. The deregulation of the securities investment system for mainland China is also being implemented from the ready, such as the expansion of the target stocks of Stock Connect on March 13, 2023.

The third issue is the construction of a cross-border settlement environment under the new RMB internationalization policy. The People’s Bank of China’s Monetary Policy Report for the second quarter of the same year (April to June), published by the People’s Bank

of China on August 10, 2022, clearly stated that (1) RMB internationalization should be continued and prudent, and (2) convertibility of RMB capital transactions should be steadily promoted. However, in the political report of the 20th Party Congress of the CPC held in October 2022, the expression was changed from “steadily” to “orderly” to “promote the internationalization of the RMB in an orderly manner.” Behind this change in wording, some researchers explain, “Further solidify the speed of RMB internationalization and further strengthen proactive and systematic efforts” (Yonghong, Vice President, Institute of International Monetary Research, Renmin University of China).

Under this new policy of RMB internationalization, in 2023, first, from January 3, trading hours in the Shanghai foreign exchange market were extended from 9:30 AM to 11:30 PM local time to 3:00 AM the following day. The measures are taken to enhance the convenience of transactions for investors in Europe and the United States with time differences and to further enhance the attractiveness of investment in renminbi denominated assets. Second, on January 11, the Ministry of Commerce and the People’s Bank of China jointly issued a notice to support cross-border renminbi payments by firms involved in foreign economy and trade, urging banks not only to conduct trade transactions but also to support firms’ financial needs for renminbi investments and loans in overseas markets. Thirdly, it was informed that by March 30, China and Brazil had agreed to settle trade and financial transactions between the two countries in yuan and real, without intervening U.S. dollars. Fourth, on March 28, at the Shanghai Petroleum and Natural Gas Trading Center (established in March 2015), the settlement of the first RMB-denominated liquefied natural gas (LNG) transaction was completed between China Offshore Petroleum (CNOOC) and French oil giant Total Energy, and approximately 65,000 tons of oil from the UAE was delivered. The RMB LNG trade was also a response to President Xi Jinping’s call for the full use of the functions of the Shanghai Oil and Natural Gas Trading Center at the First China-Gulf Cooperation Council (GCC) Summit held in Riyadh, the capital of Saudi Arabia, on December 9, 2022, to promote renminbi payments for oil and natural gas trade. In the future, the Center, in cooperation with CIPS and domestic and overseas financial institutions, has indicated its policy to construct a safe, stable and efficient cross-border renminbi payment system for oil and other products.

#### *VI-5. Finally*

RMB internationalization has not proceeded linearly in each stage by setting a schedule beforehand but has solved each problem step by step. The approach to deregulation of capital movements adopted by the design of China’s own systems, through areas such as the establishment of a RMB clearing bank, the conclusion of the renminbi denominated currency swap Agreement, the allocation of RQFII investment limits, the reciprocal trading system (Connect) between mainland China and Hong Kong for cross-border investment in securities, can be called “managed internationalization” of currency.

In addition, it seems that there was a policy intention of the financial authorities to pro-

mote market-making reform (efficiency in the allocation of financial resources) by using the entry of SDR component currencies as a trigger, but they may have learned a lesson that capital outflow is caused by the rapid internationalization. The internationalization process itself has become an intellectual property for the Chinese authorities and may be referred to in the technical assistance for the internationalization of currencies of emerging and developing countries in the future.

In the future, the internationalization of the RMB may be promoted under the policy of “orderly promotion” described in the political report of the 20th Party Congress, while enhancing the strategy based on the international situation. And domestic cities with major financial markets such as Shanghai City are given the role of the advance experiment for the RMB internationalization. In particular, Shanghai is planning to conduct an experiment on offshore renminbi trading, and it is noteworthy what kind of system design will be carried out in relation with Hong Kong.

On the whole, the internationalization of the RMB will enhance its presence in international financial markets, while it will also have to take into consideration the effects of its own monetary and exchange rate policies in the context of the trilemma of international finance. In this sense, it is difficult to say that the government is ready to review the international monetary system with a single concentration of the U.S. dollar, to enhance the weight of non-dollar settlement and the international status of the renminbi, and to play a role as an international public good (basic currency) like the U.S. dollar after World War II. In addition, both CIPS and digital yuan have been designed based on the international transaction infrastructure of SWIFT, and in order to construct China’s own international settlement network in the international financial market, the approval of existing stakeholders in the international financial community is required. In addition, China alone cannot bear all the costs (cost, time) of network construction. Therefore, for the time being, the role and settlement ratio of national currencies in regional cooperation frameworks such as RCEP and BRICS will be increased, and the government will continue to aim for the initiative of rule formation in the global international financial framework.

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