



# Comments on Eswar Prasad's “The Renminbi’s Ascendance in International Finance”

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**Menzie D. Chinn**

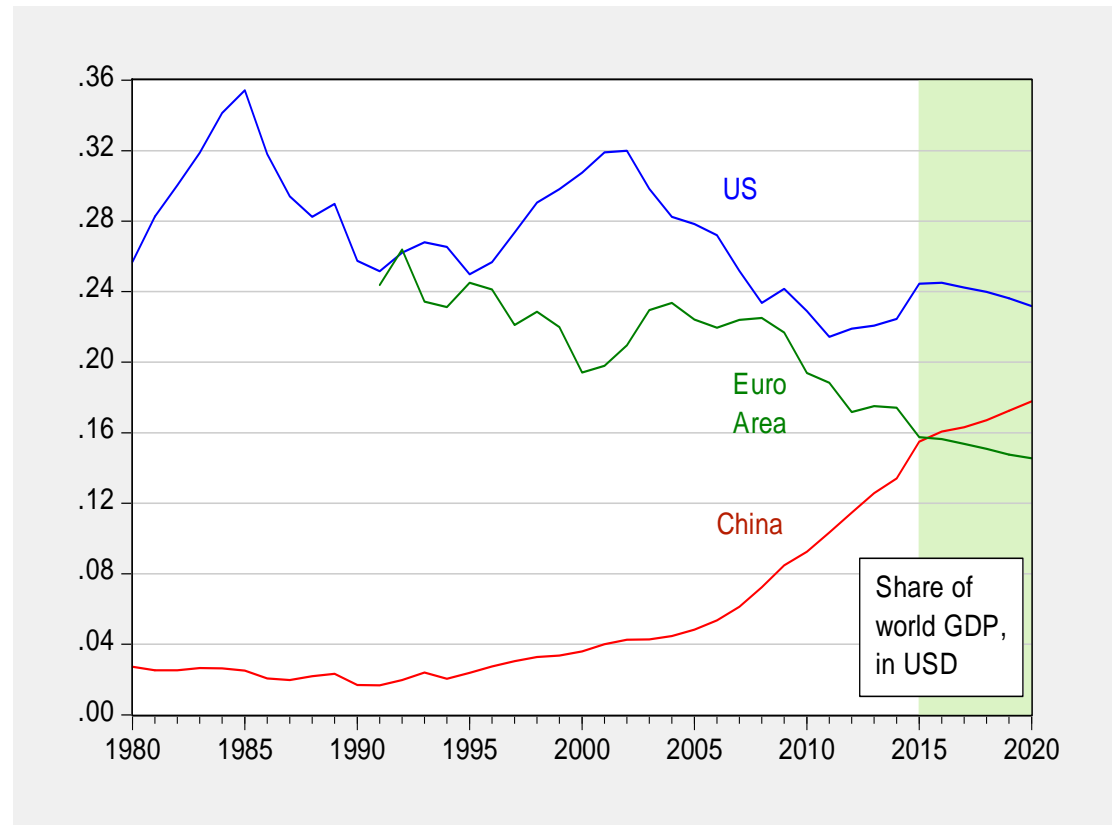
University of Wisconsin, Madison  
and NBER

15<sup>th</sup> Annual EAP Conference on  
“Policy Challenges in a  
Diverging Global Economy”  
Federal Reserve Bank of San Francisco  
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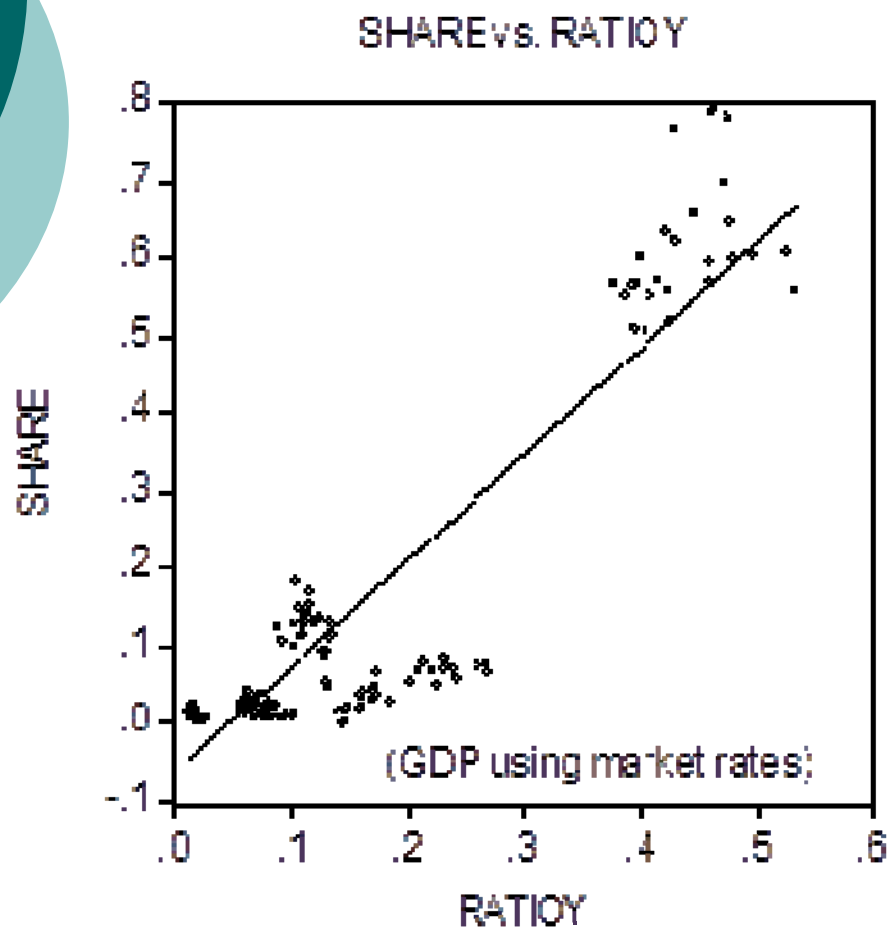
# The Key Prediction

“Given China’s sheer size and its rising shares of global GDP and trade, these steps are gaining traction and portend a more prominent role for the RMB in global trade and finance.”

-Prasad (2015)



# Economic Mass Is Not Enough



- Chinn-Frankel (2005) document the nonlinear relationship between GDP and share in reserve currency holdings.
- Similar likely true for other aspects of internationalization
- Which is why Prasad examines the dimensions he does

Source: Chinn and Frankel (2005)

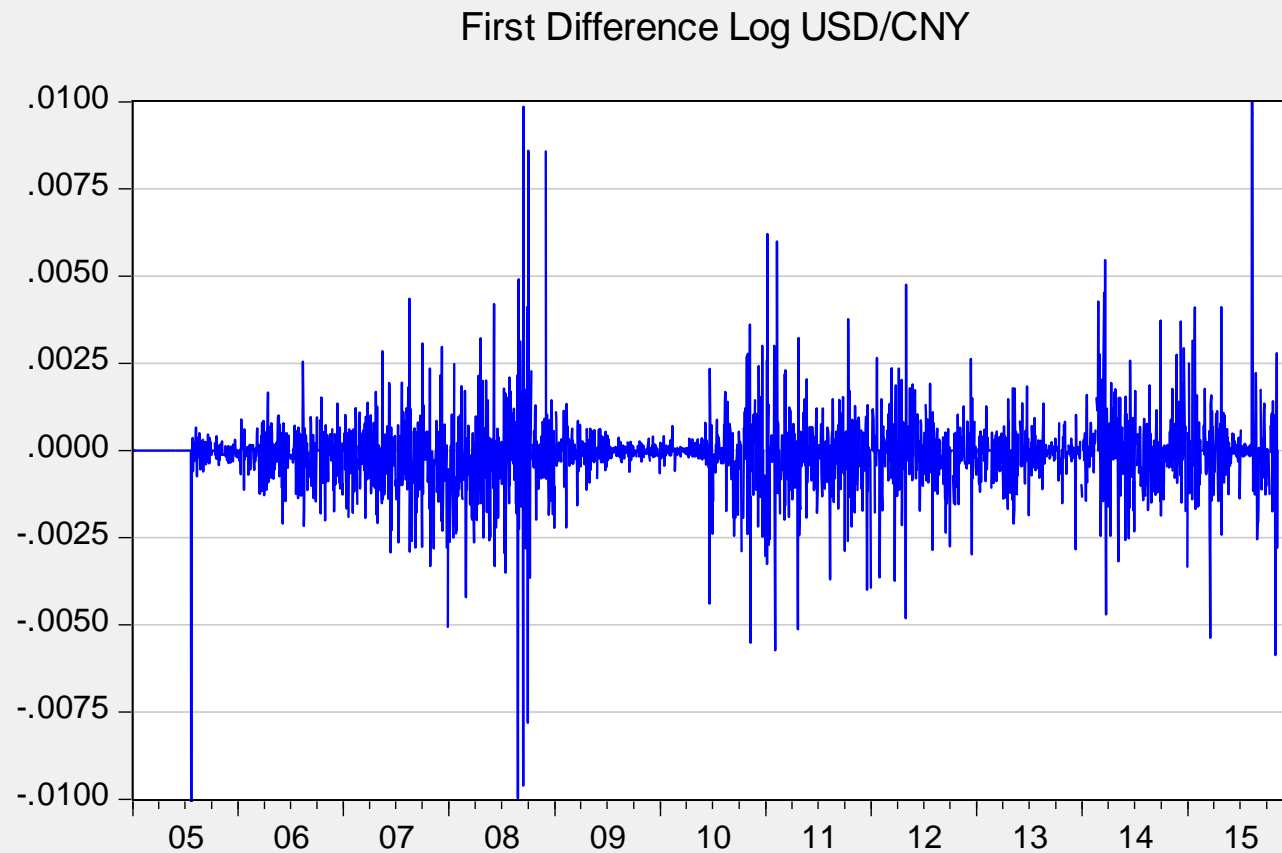


# Review of the Paper

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- Reviews recent developments in liberalizing domestic, cross-border transactions
- Reviews the pace of internationalization of the RMB
- Discusses the challenges in terms of sequencing, financial liberalization
- Concludes “RMB will become a significant reserve currency”
- Hard to dispute, given likely inclusion of RMB in SDR

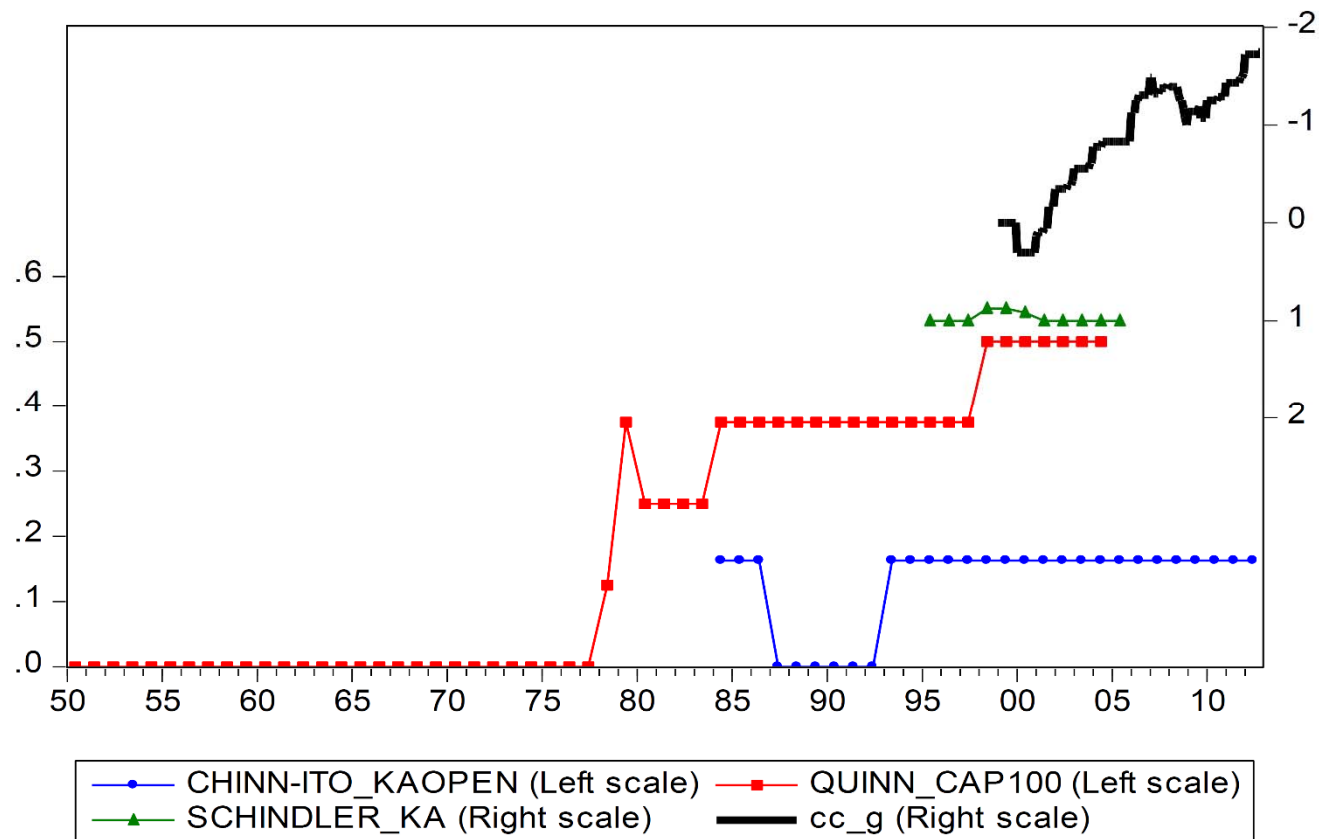
# The RMB Regime: How Much Has Actually Changed



# Financial Openness Is Key

(Partly because it drives financial development)

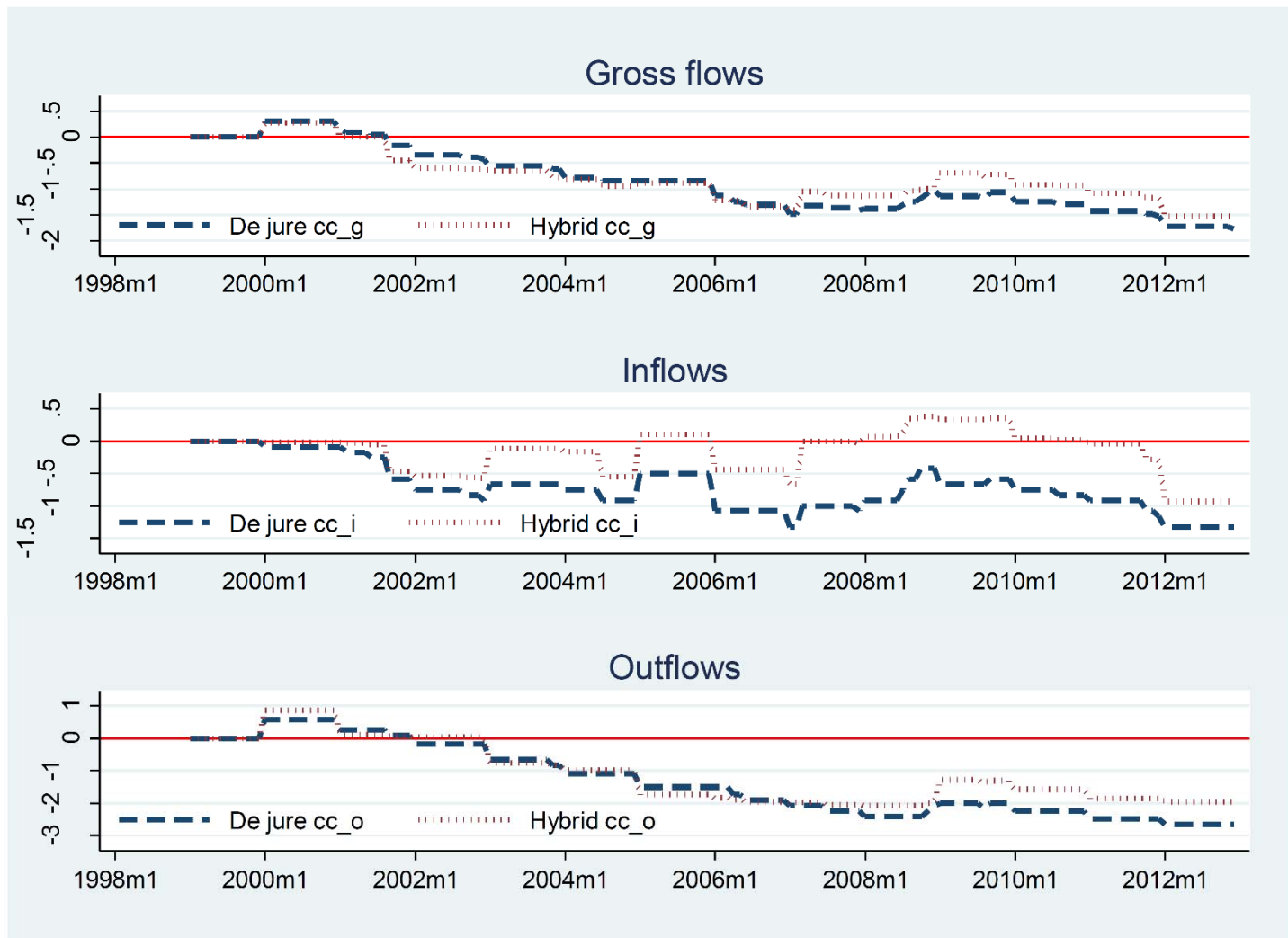
Figure 1: Comparison to other *de jure* indices



Source: Chen and Qian (2015)

# Financial Openness /s Increasing

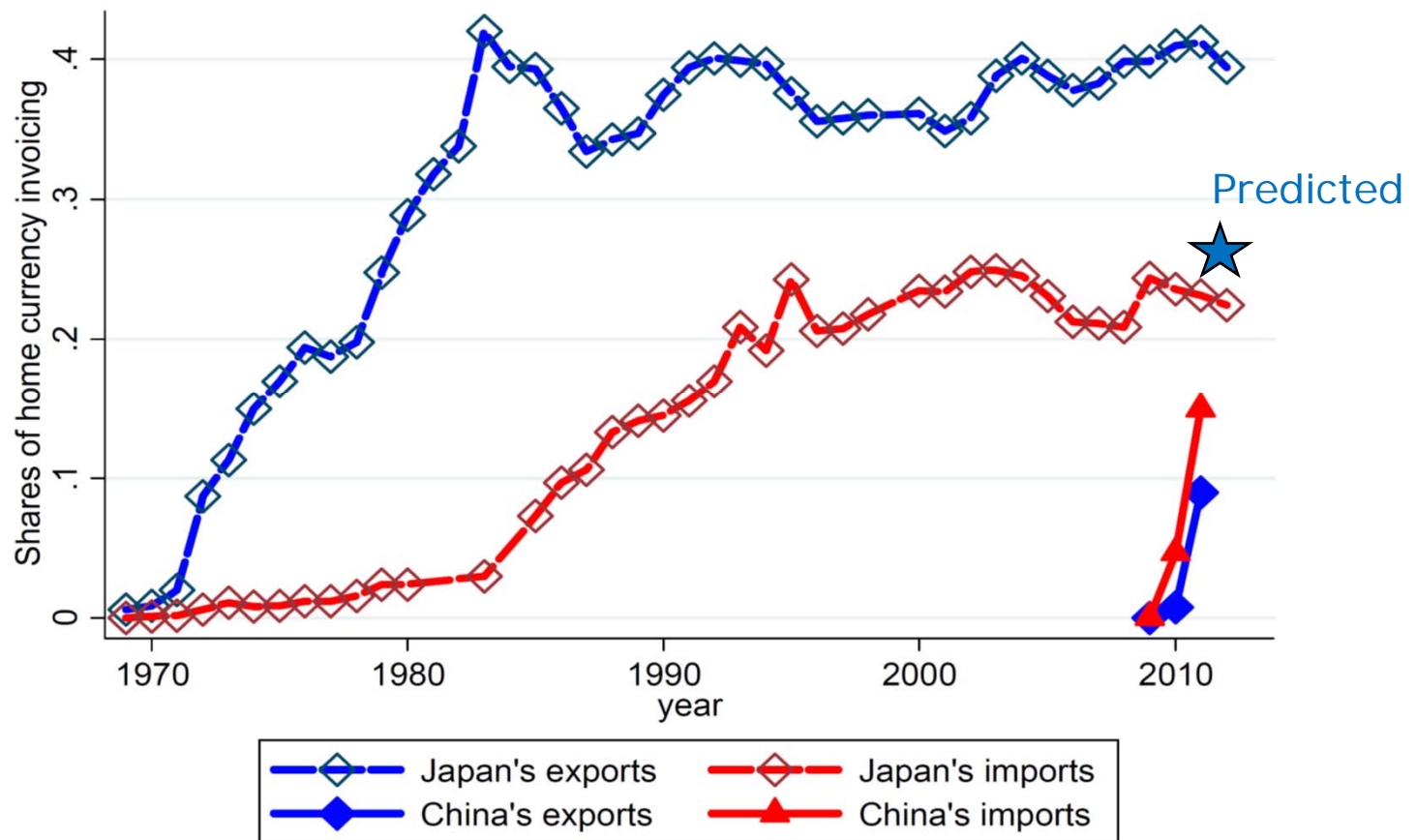
Figure 6: *De jure* and hybrid indices by flow types



Source: Chen and Qian (2015)

# And Invoicing in RMB Is Increasing

**Figure 4: In Japan's and China's Trade**



Source: Ito and Chinn (2015)





## But Reserve Currency Status Depends on most critically on:

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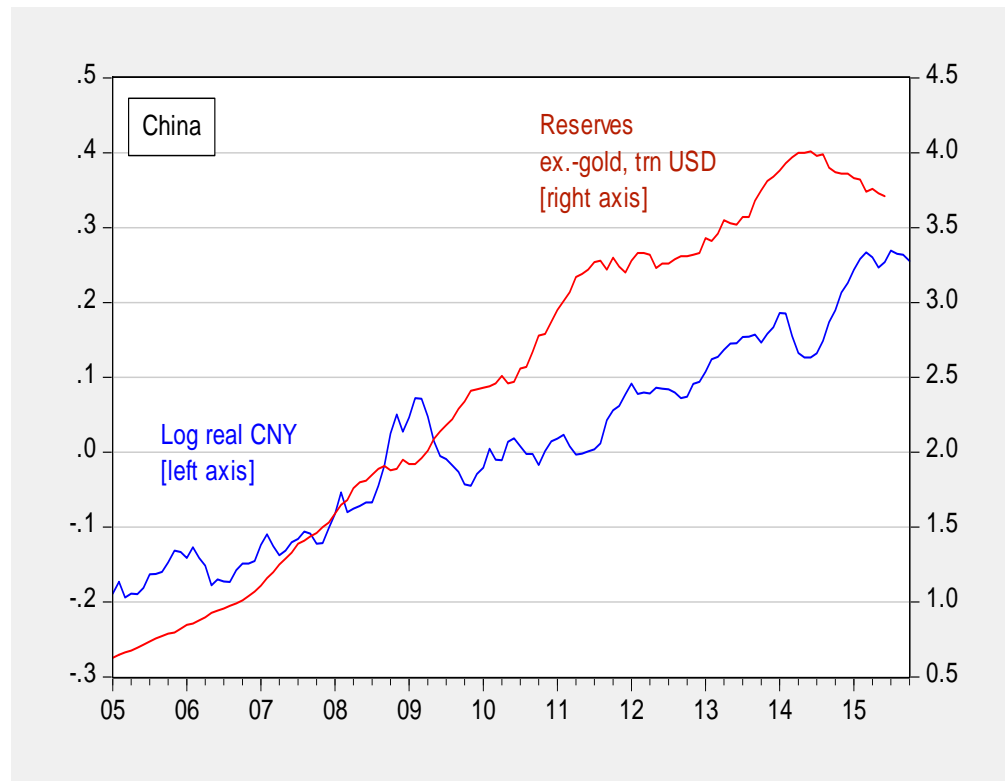
- Deep and liquid financial markets
- Proxied in Chinn and Frankel (2005) by FX turnover
- China: 0.7%
- HK: 4.1%
- When HK and China are one, *then* it's in the range of Japan's 5.6%
- Yen constitute about 2.2% of total central bank FX holdings

# Getting to the Requisite Level of Financial Development

Requires much fuller cross-border/domestic liberalization

Which implies loss of policy autonomy

...during a period of slackening growth, weak external economy





# Final Question and Conclusion

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- What price RMB internationalization in terms of policy autonomy are Chinese policymakers willing to pay?
- Given my (relatively uninformed) view, I doubt whether full capital convertibility will be achieved in the next five years (and that's not even tackling domestic financial deregulation)
- Hence, the RMB will be/is an important regional currency but only very eventually – an international one