Currency Internationalisation and Currency Hierarchy: The Importance of being an International Funding Currency

26th Annual Workshop of the PKSG Greenwich, 10th June 2016

Claes Belfrage, University of Liverpool, C.Belfrage@liverpool.ac.uk
Gary Dymski, Leeds University Business School, G.Dymski@leeds.ac.uk
Johannes Jaeger, University of Applied Sciences BFI Vienna, Johannes.Jaeger@fh-vie.ac.at
Annina Kaltenbrunner, Leeds University Business School, a.kaltenbrunner@leeds.ac.uk
Motivation

- Enrich analysis of currency internationalisation in International Political Economy (IPE) with Post Keynesian work (on currency hierarchies)
- IPE literature based on neoclassical analysis of money: focus on top currency and linear conception of currency internationalisation
- PK: application of Keynes’ liquidity preference theory to the open economy
  - Inherent hierarchy between financial assets
  - Concern with peripheral currencies
  - Currency internationalisation is shaped by and exacerbates international currency hierarchy
- This paper: Extend analysis of currency internationalisation with Minskyan dimension
  - Liability side of international balance sheets
- Will the Chinese Renminbi replace the US Dollar as top currency?
Outline

- The IPE framework of currency internationalisation
- A Minskyan Extension > The importance of being an international funding currency
- The role of the Chinese Renminbi as international funding currency
- How to become an international funding currency?
The IPE Framework of Currency Internationalisation

<table>
<thead>
<tr>
<th>Levels of analysis</th>
<th>Medium of exchange</th>
<th>Unit of account</th>
<th>Store of value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Private</strong></td>
<td>Vehicle currency (foreign exchange trading), trade settlement</td>
<td>Trade invoicing currency</td>
<td>Investment currency</td>
</tr>
<tr>
<td><strong>Official</strong></td>
<td>Intervention currency</td>
<td>Exchange rate anchor</td>
<td>Reserve currency</td>
</tr>
</tbody>
</table>

*Source: Cohen and Benney, 2014*
The IPE Framework of Currency Internationalisation - Critique

- Linear concept of currency internationalisation
- Focus on Top currency
- Neoclassical economic apparatus
  - Ergodicity and focus on money as medium of exchange/facilitate exchange
  - Unit of account: trade invoicing
A Minskyan Extension

- **Post Keynesian**
  - Fundamental uncertainty and liquidity preference
  - *Money is secure abode of purchasing power which transfers wealth in a world of uncertainty and allows meeting contractual obligations.*

- **Minsky**
  - Focus on the liability side of (international) balance sheets
  - *Money as unit of account and denominator of financial obligations*
    - Liquidity is ability to be used as a means to meet outstanding financial obligations
  - In international context: *Money as denominator of external financial obligations and liquidity as ability to meet these obligations*
A Minskyan Extension: The Importance of being an International Funding Currency

- Traditional Macroeconomic Perspective - Nation states as unit of analysis
  - Countries’ ability to issue debt in domestic currency > reduction in “original” sin and positive wealth effects
  - Countries’ Net Foreign Currency Position (e.g. Phillip Lane)
  - BUT: does not capture international use of currencies and with it financial risks
- Microeconomic Perspective - (Private) balance sheets as unit of analysis
  - Currency denomination of liability side of economic actors’ balance sheets (Bank for International Settlements)
  - National vs. Non-national
  - International funding currency: *use of domestic currency by non-nationals to fund their (international) operations* (McCauley)
A Minskyan Extension: The Importance of being an International Funding Currency

<table>
<thead>
<tr>
<th>ACTORS</th>
<th>Medium of exchange</th>
<th>Unit of account</th>
<th>Store of value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private</td>
<td>Vehicle currency; trade settlement;</td>
<td>Trade Invoicing;</td>
<td>Investment currency</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Funding Currency</td>
<td></td>
</tr>
<tr>
<td>Official</td>
<td>Intervention currency</td>
<td>Exchange rate</td>
<td>Reserve currency</td>
</tr>
<tr>
<td></td>
<td></td>
<td>anchor Funding</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Currency</td>
<td></td>
</tr>
</tbody>
</table>

Source: adjusted from Cohen and Benney (2014)
The Importance of being an International Funding Currency

- Avoid asymmetric investment currency internationalisation
  - Currency mismatches in international investors’ balance sheets
  - Large exchange rate movements, external vulnerability, financial instability and reduced monetary autonomy (Econometric Results)

- International investment vs. international funding currency
  - Different exchange rate dynamics
    - Funding currency status more conducive for development
    - Deters destabilising currency mismatches - self feeding processes
  - Different interest rate dynamics
  - Monetary autonomy

- Funding currency precondition to become reserve currency
  - “as eventually international indebtedness will be denominated in the currencies of the countries with large offshore assets, they must also accept that their currency will be a reserve currency of their debtors, for it is convenient to hold liquid assets in the currency in which your debts are denominated” (Minsky 1993).
The RMB Internationalization so far

- Relatively closed capital account but fast internationalising currency
- Relatively advanced trade related vehicle currency internationalization, e.g.
  - 2nd most important global currency for trade finance
  - 30% of China’s trade with Asia-Pacific settled in renminbi
- Increasing (?) investment currency internationalization, e.g.
  - RMB Offshore bonds app. RMB 400 bn in 2015 (2010: 50bn)
  - RMB HK Bank Deposits app. RMB 830bn (2010: <100bn)
- Very little reserve, anchor or intervention currency internationalization (SDR basket; bilateral swap deals)
RMB as International Funding Currency - Macro
RMB as International Funding Currency - Micro

- Small share of foreign nationals issue Dim Sum Bonds - China and Chinese owned entities predominate, e.g.
  - McCauley (2011): 80% of RMB issuers are Chinese nationality
  - Global Capital/Global RMB Data 2015: 467 Deals/RMB674bn
    - Chinese Issuer Parent Country: 235 Deals/RMB 474bn (70%)
- Small share of offshore renminbi denominated loans, e.g.
  - Renminbi denominated liabilities of Hong Kong banks to non-residents US$436bn compared to US58bn claims on non-residents (end 2015, BIS, 2016)
- Limited local currency funding of internationally operating banks
RMB as International Funding Currency - Micro

Local Funding Gap of International Banks operating in China
US$ Millions

Source: Bank for International Settlements
How to become an international funding currency?

- **Monetary policy**
  - Low interest rates
  - Stabilize exchange rate around mild depreciating trend
- **Regulation**
  - Require funding in domestic currency
  - Limit investment currency status
- **Official provision of loans, e.g.**
  - Colonial power, Marshall plan, Bilateral aid, Swap lines
- **International expansion of domestic banks**
  - International bank loans denominated in domestic currency
  - Joint internationalization of domestic capital
Resident Debt Securities in Local Currency as % Total Resident Debt Securities
Source: McCauley, 2011
Renminbi deposits in Hong Kong

- Renminbi customer deposits
- Renminbi certificates of deposit

$RMB$ billion

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Renminbi loans outstanding in Hong Kong

RMB billion


0  50  100  150  200  250  300  350
China’s Path to Funding Currency Micro

Source: Bank for International Settlements