

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

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# 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

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| <b>Functions of money</b> |   |                        |                       |
|---------------------------|---|------------------------|-----------------------|
| <b>Levels of analysis</b> | <b>Medium of exchange</b>                                     | <b>Unit of account</b> | <b>Store of value</b> |
| <b>Private</b>            | Vehicle currency (foreign exchange trading), trade settlement | Trade invoicing        | Investment currency   |
| <b>Official</b>           | Intervention currency   | Exchange rate anchor   | Reserve currency      |

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*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

| FUNCTIONS OF MONEY |                                     |  |                        |
|--------------------|-------------------------------------|--|------------------------|
| ACTORS             | Medium of exchange                  | Unit of account  | Store of value         |
| <b>Private</b>     | Vehicle currency; trade settlement; | Trade Invoicing;<br><b>Funding<br/>Currency</b>        | Investment<br>currency |
| <b>Official</b>    | Intervention currency               | Exchange rate<br>anchor<br><b>Funding<br/>Currency</b> | Reserve currency       |

Source: adjusted from Cohen and Benney (2014)



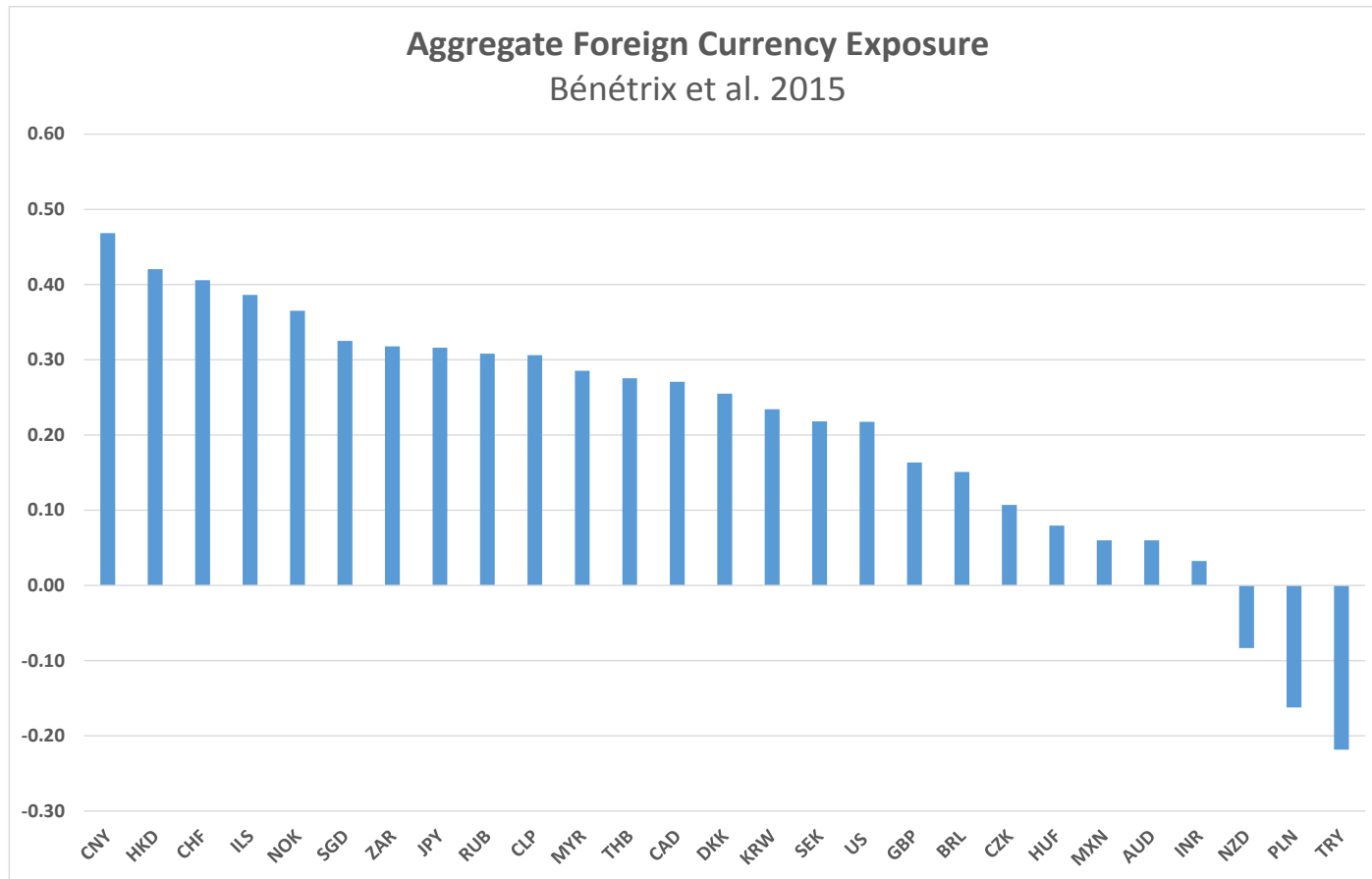
# The Importance of being an International Funding Currency

- ▶ 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.
  - ▶ 2<sup>nd</sup> 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)

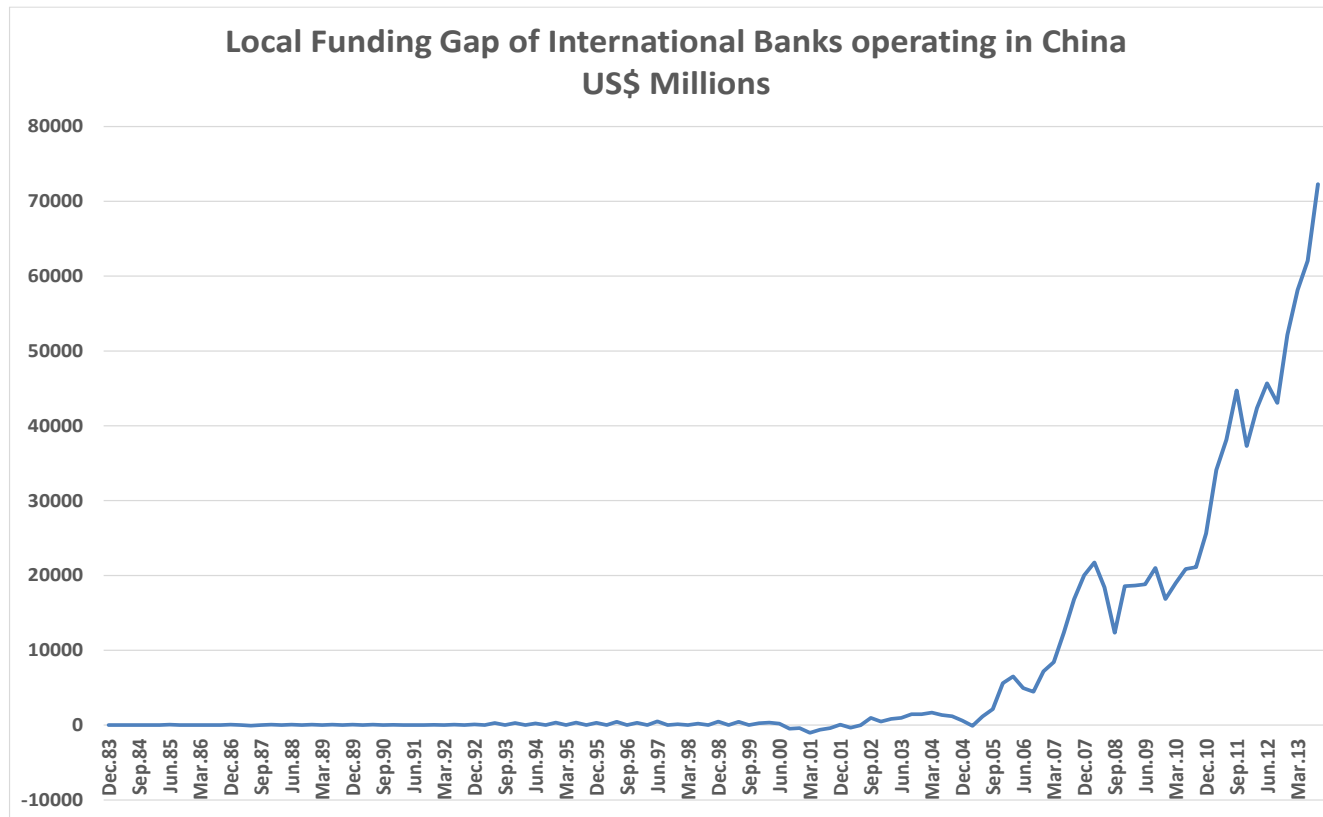
# RMB as International Funding Currency - Macro



# 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 US\$58bn claims on non-residents (end 2015, BIS, 2016)
- ▶ Limited local currency funding of internationally operating banks

# RMB as International Funding Currency - Micro



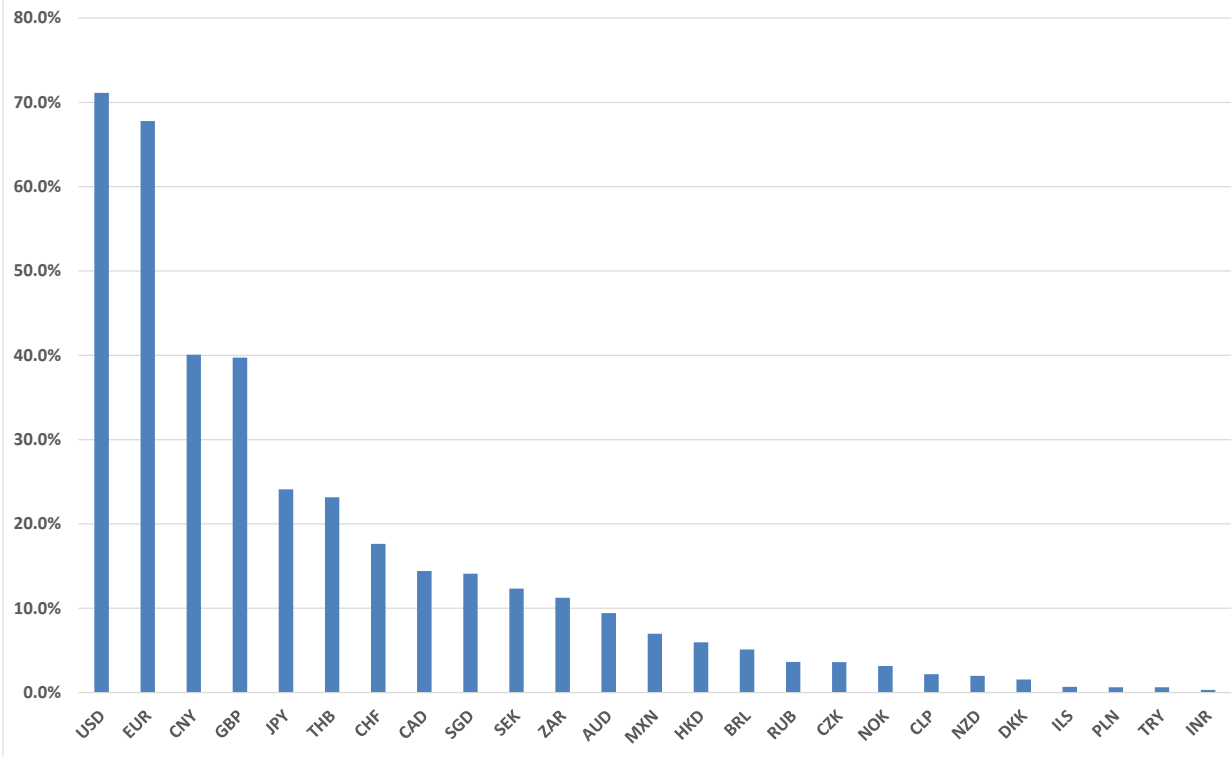
Source: Bank for International Settlements

# 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

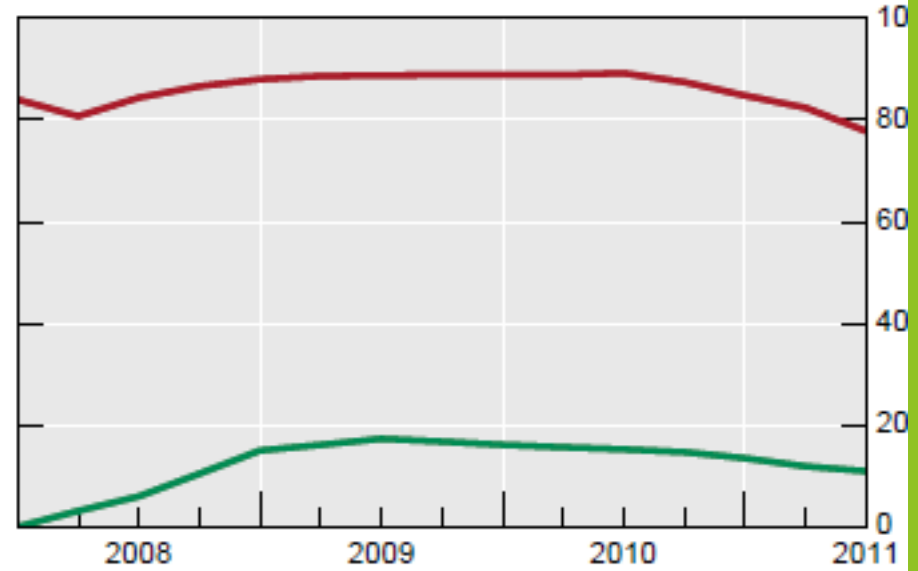
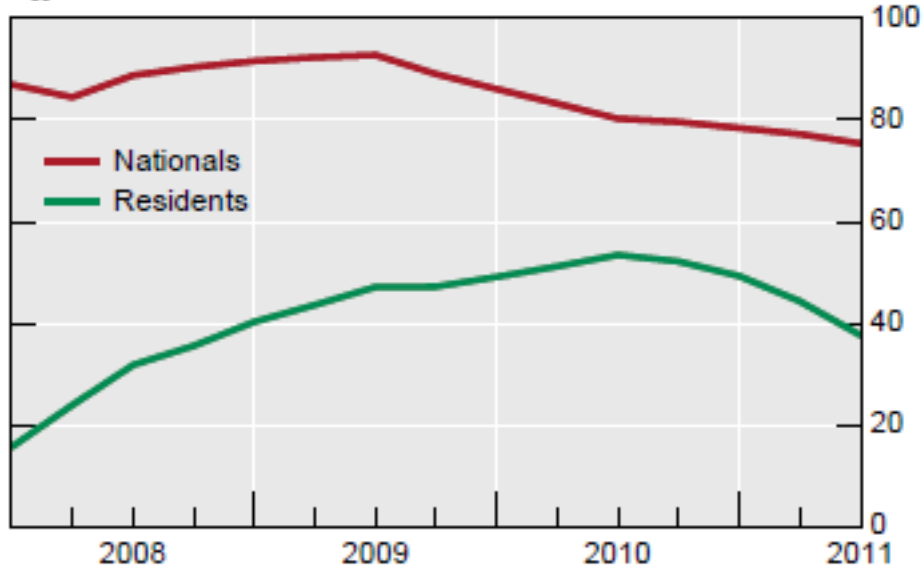


Resident Debt Securities in Local Currency as % Total Resident Debt Securities

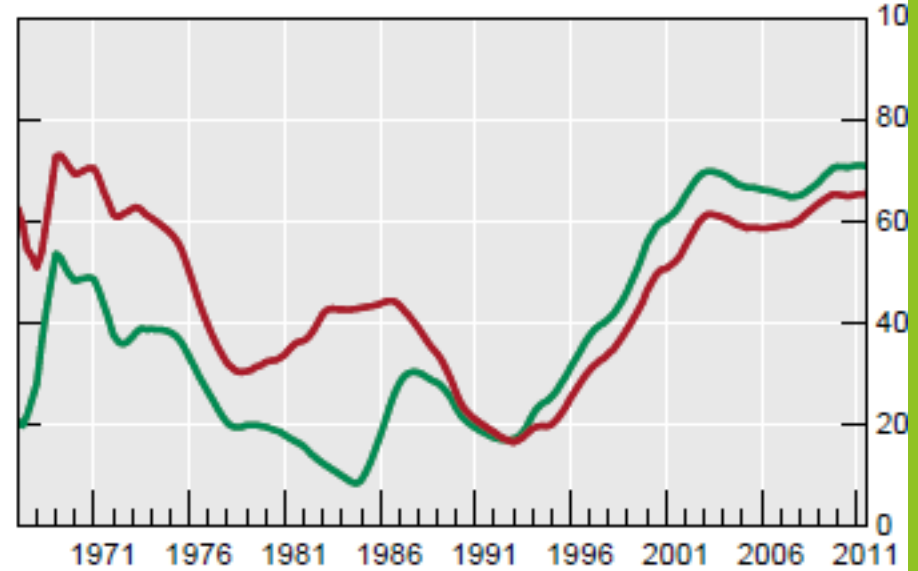
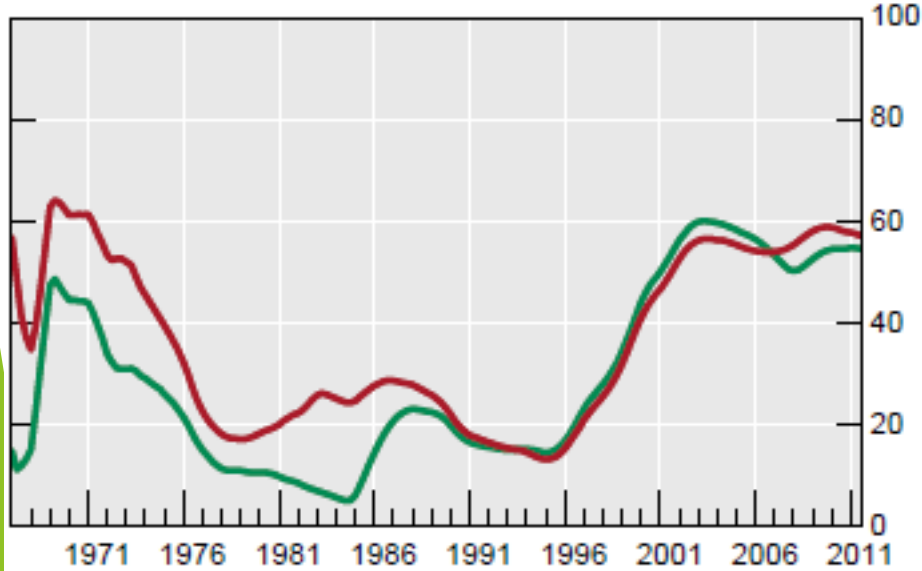




*Offshore renminbi issuers and Chinese issuers*



*Offshore dollar issuers and U.S. issuers*

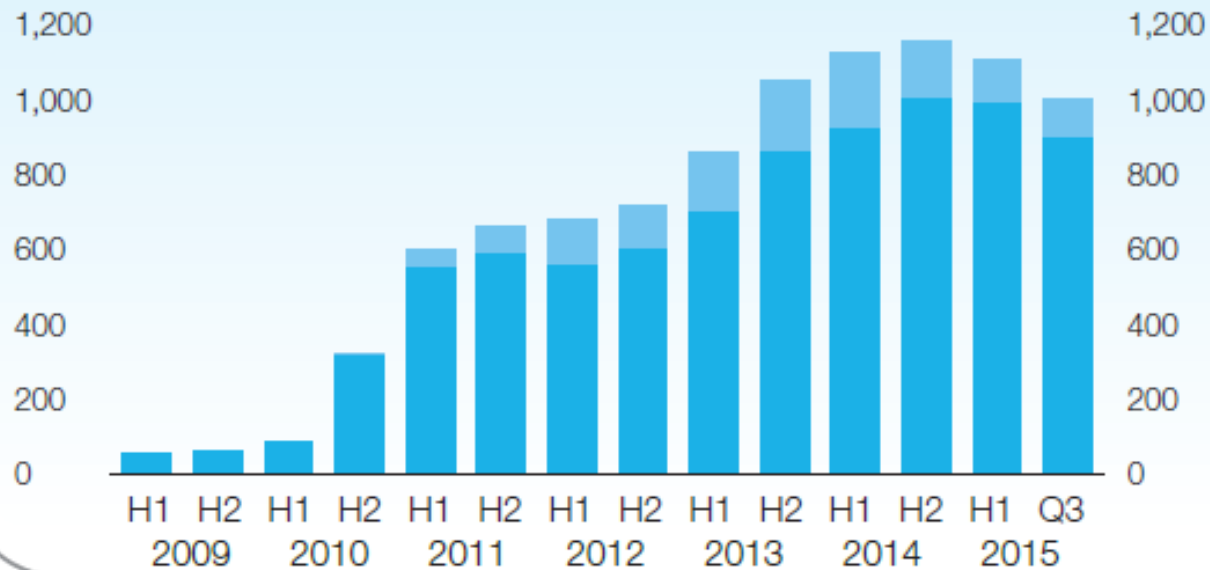


Source: McCauley, 2011

## Renminbi deposits in Hong Kong

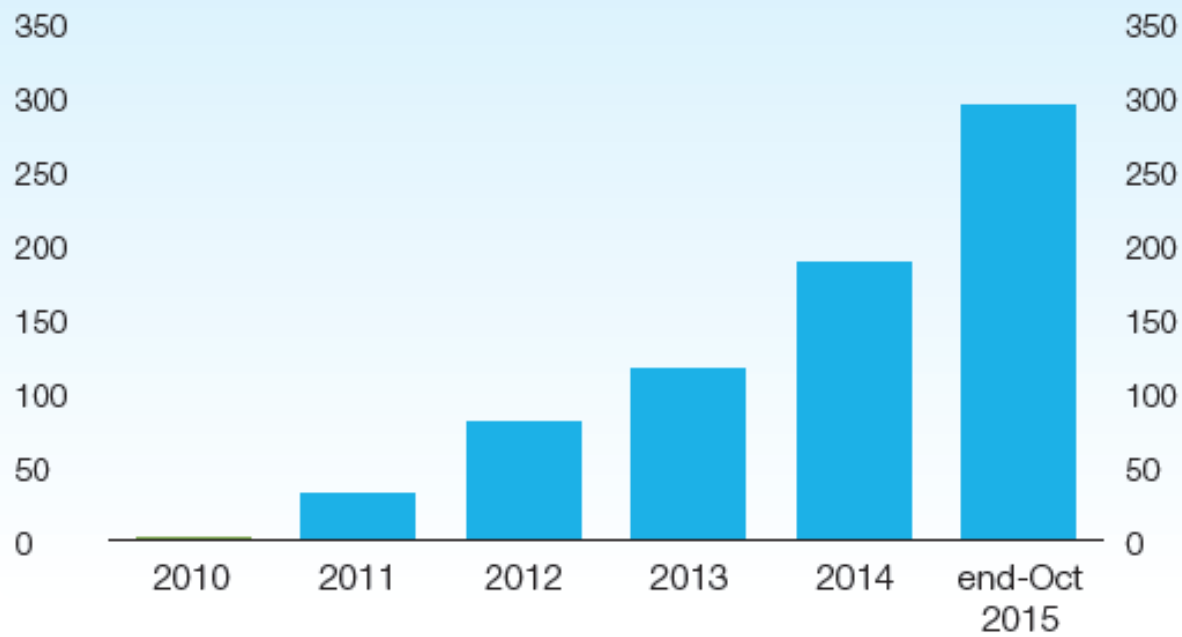
■ Renminbi customer deposits    ■ Renminbi certificates of deposit

*RMB billion*

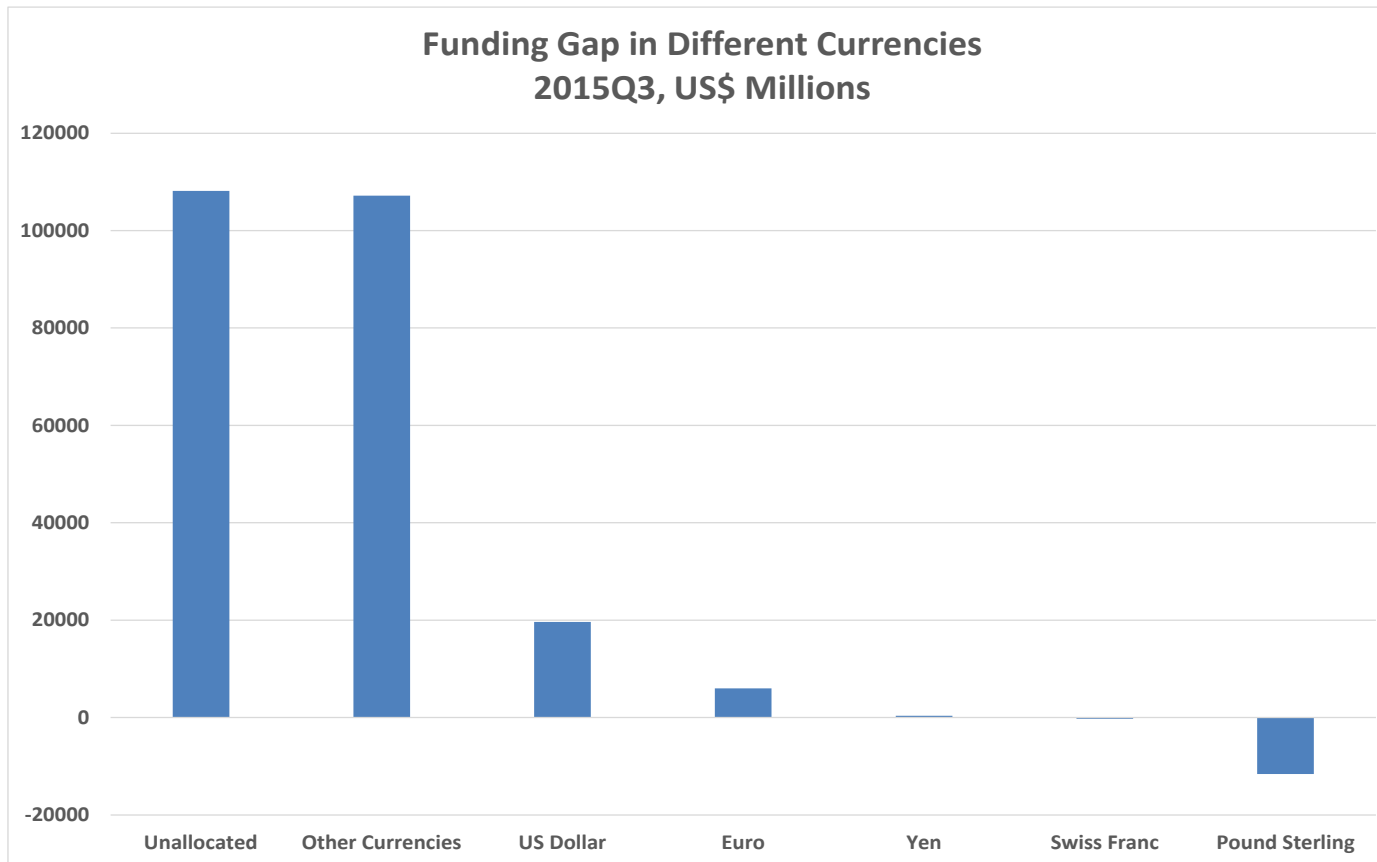


## Renminbi loans outstanding in Hong Kong

*RMB billion*



# China's Path to Funding Currency Micro



*Source: Bank for International Settlements*