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THE CANADIAN RMB TRADING CENTRE: A SMALL STEP IN THE LONG ROAD OF CHINA'S PEACEFUL RISE IN INTERNATIONAL FINANCIAL MARKETS

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EXECUTIVE SUMMARY

China is on the road to becoming a powerful force in global financial markets; statistics suggest that already some 20 per cent of the world's trade finance is currently conducted in the country's currency — the yuan, or renminbi (RMB). That is a twentyfold increase in just five years.

Canada has shrewdly connected its own financial system to that of China's, well before many other countries, in securing permission from China to host one of the world's few renminbi trading hubs. The creation of these trading hubs is an important milestone for China in the long process of the internationalization of its currency. Hosting such a hub is an important milestone for Canada, in that it can help further the increase in bilateral trade and investment, the expanding exchange of businesspeople and students, and the official presence on the ground on the part of both countries' governments.

A key benefit of the creation of an RMB trading centre in Canada is that it will enable Canadian financial institutions to develop a capacity to trade, and an expertise in trading, Chinese currency for non-Chinese financial instruments (such as stocks, bonds, etc.), and converting Canadian currency into Chinese investments. While this may seem straightforward, given the fact that so many different currencies are exchanged freely on global markets each day, the renminbi is unique in the fact that it has been a highly controlled, largely inaccessible currency. That has historically hampered its liquidity and added much more risk than is the case with other major currencies. Canada's RMB trading hub will reduce those difficulties and risks.

Just as significant, however, is the symbolism of Canada's new hub (which, really, is just a virtual hub, comprised of computer systems, rather than a physical office or trading floor). The designation of Canada as host to an RMB centre — one of just nine in the world, and the only one in North America — was the result of several years of co-ordinated and co-operative advocacy on the part of Canadian businesses and governments who recognized its future importance. And it is a more important step forward in Canada-China bilateral relations than it has perhaps been given credit for. As China marches towards internationalization and liberalization, Canada has positioned itself well as an early partner in that progress. The RMB trading centre might be just a small step, but it is a vital one, in ensuring that Canada remains closer to, and more connected to, China as it emerges as a powerful global force in the world's financial markets.

The announcement in Beijing last November that the Chinese government was designating Canada as the site of the first trading centre for the Chinese currency (the renminbi, abbreviated as RMB; or the yuan) in North America is potentially of considerable significance to Canada and particularly to Canadian financial institutions. What has become known as the Canadian RMB Centre, one of 12 worldwide (several more RMB trading centres abroad are likely to be established, although perhaps not in the U.S. for political-security reasons), will be able to clear and to settle transactions in the not-as-yet fully convertible Chinese currency anywhere in Canada. As well, the Canadian centre will be equipped to ensure that there is sufficient liquidity to handle large transactions at a relatively predictable exchange rate between Canada and China and possibly between China and other countries in the four time zones in the Western Hemisphere that are shared with Canada. The creation of these RMB trading centres around the world amounts to a series of small, successive steps in the long process of the internationalization of the Chinese currency, a policy objective of the government of the People's Republic of China that has been actively underway over the past decade or so.

The Canadian trading centre, like the other RMB trading centres that have been established in Hong Kong, London, Paris, Luxembourg, Frankfurt, Singapore, Sydney and, most recently, Santiago, Chile, is essentially a virtual, computer-based financial infrastructure domiciled in Canada. It will enable Canadian-based banks and other financial institutions to develop the expertise and capacity to accept deposits in renminbi or Canadian dollars and use them to purchase goods or services in either country or to invest in stocks, bonds, or other financial assets in Canada or China without having to involve the transaction costs and risks of using an intermediary currency such as the U.S. dollar or the euro. As a result, it will be faster and more efficient than the financial arrangements used in the past in conducting international trade or investment transactions between the two countries. Further, the potential cost of exchange-rate volatility will also be lessened to some extent. Risks for traders, investors, and individuals, therefore, will be reduced somewhat by the existence of the trading centre.

Yet the Chinese currency, unlike the Canadian dollar and other fully convertible currencies, will not be completely free to find its own market-based equilibrium: capital controls, at a fixed, albeit frequently adjusted exchange rate (adjustments occurred twice in early August 2015) will remain in place with respect to the RMB, and Chinese monetary policy will continue to remain tightly regulated by the central government. All of this could, and likely will, change over time; the RMB trading centres are only one step towards full internationalization of the currency.

The designation of Canada by the Chinese government to host an RMB centre was the result of several years of co-ordinated and co-operative advocacy on the part of Canadian businesses, Canadian financial institutions in particular, and Canadian governments at all levels. The Toronto Financial Services Alliance and Advantage BC were particularly strong supporters of, and advocates for the initiative, with help from many quarters of the larger Canadian community. At the outset, there was some rivalry between major Canadian centres to attract what was understood to be a "bricks and mortar" operation;[1] when the "virtual" nature of the trading centre became clearer, and particularly when the computerized nature of

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[1] Nathan Vanderklippe, "Toronto and Vancouver battle to house yuan trade," *The Globe and Mail*, February 17, 2014, http://www.theglobeandmail.com/report-on-business/international-business/toronto-and-vancouver-battle-to-house-yuan-trade/article16926093/.

the centre became better understood, all sides from across Canada joined in a common front to seek such a designation by the Chinese authorities. The government of Canada also was supportive: The announcement of the Canadian RMB Centre became part of the outcome — the "deliverables" — of the prime minister's visit to China in November 2014.[2] The trading centre became operational some five months later, in March 2015.

The Canadian centre is based on three elements agreed to by both governments last November. The first is a memorandum of understanding between the two governments to establish a regular dialogue on the conduct of RMB business in both countries, to review the evolution of RMB-clearing operations as they develop, and to track liquidity conditions in Canada. The second component underpinning the establishment of the Canadian trading centre was the creation of the Renminbi Qualified Foreign Institutional Investor (RQFII) program of up to 50 billion yuan (approximately $9.3 billion) to ensure sufficient liquidity at the launch of the centre. Finally, a three-year swap arrangement between the Bank of Canada and the People's Bank of China was established to ensure the stability of each country's financial system by providing a reserve of liquidity — this swap arrangement being modelled after those that Canada and China have with central banks of their other international economic partners.[3]

The Canadian trading centre will facilitate largely low-risk trade and investment between the two countries by initially providing trade financing to firms engaged in, or wanting to engage in trade or investment across the Pacific. It might, in particular, help smaller and medium-sized firms become more active in the bilateral economic relationship as most firms of this size lack the capacity to involve themselves in constantly changing, higher-risk financial markets by means of foreign-exchange hedging or by other mechanisms. Given the fact, as well, that all the time zones within the trading region of North America and the Caribbean are covered by the same time zones that exist within Canada, there remains the possibility that some firms based in other parts of the Western Hemisphere, particularly those firms already accustomed to using Canadian-based financial institutions, might see an advantage in using the Canadian trading centre. In this latter case, only time will tell if non-Canadian-based firms will find it advantageous to use the Canadian centre as the reach and experience of Canadian-based financial institutions expand to provide this faster, slightly less risky service.

Nevertheless, as important as the clearing and settlement of financial accounts are in international trade and finance matters, it is by no means the whole story when it comes to international trade-and-investment activity and performance. In the larger scheme of things, such activity will continue to depend on what each country and each firm within that country, can produce and when, what the trading or investment partner wants, and at what price. We know from casual observation of how business operates, and also from scholarly research, that the performance of any given country's international trade and investment depends

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[2] Janet Ecker, "Yuan trading-hub status a major win for Canada," *The Globe and Mail*, November 11, 2014, http://www.theglobeandmail.com/report-on-business/international-business/yuan-trading-hub-status-a-major-win-for-canada/article21541747/.

[3] In Canada's case at least, swaps have never needed to be used — even following the financial crisis of 2008–09 — but they are always available as a backstop.

primarily on the economic growth — or expected economic growth — of one's trading partners; secondly, on exchange rate levels; and thirdly, on trade and financial rules and practices — the rules of the road.

Yet the establishment and the beginning of operations in March 2015 of the Canadian RMB Trading Centre is a step forward in terms both of the Canada-China bilateral relationship and of the gradual internationalization of China's currency. Current volatility notwithstanding, and accepting the reality of the relatively small volume and value at present of bilateral trade and investment, China is rapidly becoming the world's largest economy and trader, as well as the source and destination of much of the world's investment. Its currency, thus, is of international importance. According to various press reports, some estimates emanating from the People's Republic of China's Premium Database and the International Monetary Fund's Direction of Trade Statistics[4] suggest that currently some 20 per cent of the world's trade finance is already being conducted in the Chinese currency (a twentyfold increase in five years) and that the RMB is already the world's eighth-most-traded currency after the U.S. dollar, the euro, the pound sterling, the yen, the Swiss franc, the Australian dollar, and the Canadian dollar. The RMB is also now becoming part of the IMF's Special Drawing Rights's liquidity basket, thus, in effect, becoming recognized as an official global reserve currency.[5] Meanwhile, within China, steps continue to be taken as part of the "new normal" (lower GDP growth, more open markets, and a more domestic, less export-focused policy orientation) to gradually reduce capital controls, improve domestic financial regulation, and provide for more monetary-policy flexibility. The march towards Chinese internationalization and liberalization, that is, continues, of which the creation of the Canadian RMB Trading Centre is a part.

From the Canadian perspective, the new Canadian RMB Trading Centre, while a relatively uncontroversial development, reflects the increasing volumes of trade and investment between the two countries, the expanding exchange of businesspeople and of students, the increased official presence on the ground on the part of both countries' governments, and the possibility of more investment as a consequence of the recent conclusion and ratification of the Foreign Investment Protection Act (FIPA) between the two countries. More can and will be done — the complementarities study on the prospects for increased trade in seven sectors, undertaken jointly by both governments several years ago and released to the public in May 2012, provides a solid and clear foundation on which to build.[6] Ongoing decisions by governments, businesses, individuals and other groups will put into practice over time what their interests dictate in terms of the growth of the bilateral economic relationship.

In a broader, worldwide context, the progressive internationalization of China's currency is an expected and normal result of China's increased share of, and consequent responsibility for the larger world economy. It will require continuing domestic reform within China as well, with all the uncertainties and occasionally severe volatility that this process of gradual liberalization entails. But a more tradable currency internationally is to be welcomed by all as China takes its rightful place in the community of nations.

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4 See B. Eichengreen and M. Kawai, "Issues for Renminbi Internationalization: An Overview," ADBI Working Paper 454 (Tokyo: Asian Development Bank Institute, 2014), 5.

5 ibid., 17.

6 Foreign Affairs and International Trade Canada and Ministry of Commerce of the People's Republic of China, Economic Partnership Working Group (May 2012).

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