

Crouching Dollar, Expanding Yuan

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"When somebody writes the history of our time 50 or 100 years from now, ... it will be about how the world adjusted to the movement of the theatre of history towards China." Lawrence Summer in the Wall Street Journal, November 2010

After three decades of premier Deng Xiao Ping's economic "reform and open up" policy as well as the Asean-China Free Trade Agreement, Thailand's trade with China has increased tremendously. Recent data show that China is now Thailand's top trading partner and China accounts for more than 10 per cent of Thailand's imports and exports.

Speaking of its currency, China has recently pushed to promote yuan internationalisation and has designated pilot regions for the cross-border yuan trade settlement programme, allowing its currency to become more readily available beyond its borders so as to reduce its reliance on the US dollar for trade and finance.

On top of encouraging the role of the yuan as a future global currency, the 12th five-year plan also pushes capital account convertibility to be in line with the needs of China's economic development through improving the management of capital inflows as well as expanding channels of capital outflows.

As far as the yuan liberalisation process goes, offshore yuan trade settlement has been increasing at a fast pace since the first quarter of 2010.

Amid the growing appetite for the Chinese currency, several commercial banks in Thailand have started to offer yuan-denominated financial products and services, such as yuan deposit accounts and letters of credit, to their clients in order to give companies more choices for trade payment.

However, those products and services are relatively limited and the volume of transactions denominated in yuan is still negligible.

This is partly due to the lack of understanding of the rules and practices for using the yuan to settle international transactions, and partly due to the higher bid-ask spread compared to the US dollar.

This is understandable since most international trade transactions are settled in US dollars and the market for US dollars is more liquid.

As more people offshore hold yuan and use it for settlement, the currency will naturally become more liquid. However, in order for yuan internationalisation to become successful, full convertibility of the yuan and liberalised capital accounts are indispensable.

China's financial system also needs to be liberalised and strengthened in order to develop deeper, wider and more liquid financial markets, allowing for, among others, accessibility to foreign-exchange risk management.

In other words, the ultimate success of the yuan internationalisation process will depend both on China's policies as well as its currency's credibility and the confidence of yuan holders in other countries. For Thailand, on the possible move towards a multi-polar currency world, it is necessary to develop and prepare our domestic financial market to stay ready and offer Thai businesses a variety of settlement currency options.

Then Thai companies will have more alternatives to find the most suitable approach to settle their cross-border trade transactions, which will eventually help reduce the over-reliance of firms on any one single currency.

Now China is gaining influence, so much so that even Mickey Mouse has to give way to Kung Fu Panda in Hollywood. Even though it still has a long way to go to make its currency and financial instruments more available to foreign investors, the US dollar may have to share its most-favoured status with the yuan if China's liberalisation plan becomes successful.

(The views expressed are the author's own.)

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