Meet the next global currency. China’s renminbi (RMB), also called the “redback,” in 2013 became one of the world's top ten most-used currencies. By 2020 it will be widely used in international trade and finance. Canada should position itself for this sea change.

Pragmatism is the hallmark of China’s approach to internationalizing its currency: promote its use in settling foreign trade, encourage its use in cross-border investment and establish offshore renminbi centres. Internationalization will also depend on major domestic reforms to produce a modern, strong and diverse financial system with sufficient sophistication, liquidity and depth to manage volatile exchange rates and capital flows. Indeed full capital account opening will require China to offer world-class financial services in such centers as Shanghai. There is a distance to go. The bank-dominated financial system still lacks transparent and credible equity and bond markets. Both interest rates and the exchange rate are politically-determined. Change is accelerating, however, as the exchange rate becomes more flexible and increasing volumes of trade transactions are settled in renminbi. Offshore settlement centres in neighboring Hong Kong, Singapore and Taipei have been joined by Frankfurt and London where, in late March their respective central banks signed agreements with China’s central bank to become RMB payment hubs. Each centre is given a quota that allows banks in those countries to trade the redback freely.

What about North America, and more importantly, Canada? Surprisingly, there is no such centre yet in the western hemisphere. China has become Canada’s second largest national trading partner after the United States; merchandise trade has more than doubled in recent years while services trade doubled in the past decade. The two countries’ economies complement each other, with Canada exporting the natural resources China needs and importing many consumer and other finished goods in return. An offshore settlement centre in Canada would reduce the costs of these transactions (currently settled in US dollars and then changed into RMB); it could also offer RMB settlement services elsewhere in the hemisphere. China would welcome a stable, prosperous nation such as Canada extending the use of renminbi in international trade. As trade continues to increase, it would also be one of the stepping stones to a deeper overall bilateral economic relationship.

The government of British Columbia is already using the renminbi. In November 2012 it issued RMB-denominated bonds to finance its debt, selling almost RMB 2.5 billion in securities. Demand exceeded supply, with forty two investors requesting RMB 4 billion, making this “dim sum bond” such a success that the BC government may issue future debt in this manner. British Columbia’s decision was a vote of confidence in the future international use of China’s currency and created a win-win outcome for both countries. As a high-quality foreign issuer using the renminbi it opens new opportunities for the Canadian financial sector and more choice for borrowers wishing to diversify beyond reliance on the US dollar. It would also encourage Canadian businesses active in China to use the renminbi to settle transactions.
The idea of Canada moving first to establish such a centre is not new; groups in both Toronto and Vancouver are pushing for this role. Most Canadian banks have yet to assist Canadian firms wishing to access directly RMB instruments. Canada’s merchandise exports to China totalled more than $20 billion in 2013 while its imports were over $50 billion; ready supplies of renminbi would reduce transactions costs and exchange risk. Once financial transactions reach a critical mass, to prevent shortages he Bank of Canada could increase the supply through a bilateral currency swap agreement with the People’s Bank of China. More than twenty such agreements already exist. This added liquidity would boost confidence in renminbi trading, facilitate investing in RMB products and settling transactions. Swap lines are not always drawn upon, but they are a significant piece of financial infrastructure required to internationalize the renminbi and support global markets.

The offshore Chinese currency market has immense potential. In 2013 China became the world’s biggest goods-trading nation, with trade totalling US$ 4 trillion; nearly 20 percent was settled in RMB (up from 3 percent in 2010). From 900 financial institutions conducting business in RMB in 2011, the number is now more than 10,000. Each year since 2008 the offshore renminbi bond market has doubled in size. By 2015, about 30 percent of China’s cross-border trade will be settled in the currency, making it one of the three most used currencies in global trading along with the U.S. dollar and euro. In some ways, the renminbi has already achieved the status of international currency.

Canada has little to lose and much to gain from RMB internationalization. An offshore settlement centre and currency swap would signal serious intent to diversify our markets and adjust to the shifting centers of gravity in global finance. In Asia, where Canada is almost invisible, this move would help put the country back on the map.

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