

China and the world economy

The politics and economics of the renminbi - the link with the coming Chinese retail banking revolution

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I

It is a great pleasure to be here in Beijing today to speak about the links between the more micro-economic issues of the growth in Chinese retail banking and the wider global macro-economic framework. I have three fundamental messages for you.

First, the challenges and opportunities resulting from the ascent of the Chinese consumer will be one of the most important single influences – both direct and indirect – on the world economy for the next 30 years.

Second, the revitalisation and dynamisation of the techniques and technology of retail banking will be one of the accompanying forces behind this transformation. I am reasonably sure that there will be a general resurgence of science and technology in China during this coming period. This will include progress in the technology of retail banking, where China can become both a laboratory and a springboard for numerous bold large-scale experiments that will send waves around the world. China will be a leader in many areas, and one of them will be in the technology of retail banking.

Third, there has been a lot of doom and gloom about the Chinese role in the world economy, especially about China's propensity to record large trade surpluses and its alleged refusal to espouse a policy of raising the value of the renminbi and boosting domestic demand. This has been criticised as holding back the development of the world economy. I have myself contributed in a small way to this debate by baptising as "Chimany" the union of the two big surplus countries – China and Germany – in a newspaper article that I wrote last August. Certainly there will have to be, at some stage in the future, greater flexibility in the renminbi exchange rate. However to heap all the blame on to China for so-called world payment imbalances is unfair, counter-productive

¹ Yale University Press. Published in German as *Der Euro: Die geheime Geschichte der neuen Weltwährung* (Murrmann Verlag). http://www.londonandoxford.com/The_Euro/The_Euro.htm

and irresponsible. I will have more to say about this later. For the time being, let me remark that China will have an important part in producing a more balanced world economy by shifting its own economy over time to more domestic demand and domestic consumption – and retail banking will have an important role to play in this.

II

Let me give you some historical background, always necessary when dealing with China. One needs to have a perspective that brings in developments over the past 500 years. During the period between 1500 and 1820 – the birth of the first great era of globalisation - Asia in the form of China and India made up the lion's share of the world economy, representing 50 to 60 % of world GDP at one stage, declining gradually to around 45% in 1820. This was roughly in line with Asia's share of world population of over 50%. Then followed, in the case of both, but particularly of China, a period of economic stagnation that lasted 150 years, in which Europe, the US and then Japan grew greatly in economic output but the share of the Big Two Asian countries in the world economy slumped dramatically. Today, even after the economic renewal of the past 20 to 30 years, the Asian share is only roughly halfway back to the share of the world economy that you could say it should rightfully have on account of its large population. In other words, China has made some impressive strides, but it has a long way to go.

It is important to recognise that, unless something dramatically bad happens, Chinese GDP will surpass over the next 20 years that of the United States as the largest economy in the world. But GDP per head is currently only one-tenth of that of Japan. Even more significantly, GDP per head here is only one-eighth of Hong Kong' and one-fifth of South Korea's – two countries that followed Japan in the economic growth surge in Asia over the past 50 years, but set economic models that China is now following.

So there will be a large-scale phenomenon of catch-up – the largest the world has ever seen – as China's wealth, dynamism and entrepreneurial flair gain momentum and spread out across the population. Nothing ever goes in a completely linear fashion, and nothing in China will be completely smooth. There will be setbacks and turbulence along the way. This will bring great political challenges. But all this will be done in a way where there is a synthesis and a symbiosis with the resurgence of the consumer through the forces of Chinese retail banking.

III

There will be a clear link between the factors driving the liberalisation of domestic financial services and the financial markets and the internationalisation of the renminbi. These processes need to go step in step. Over time China will move to a more flexible policy for the renminbi exchange rate that will allow the Chinese monetary authorities to enjoy greater autonomy over monetary policy at home. But this will be at a time of China's own choosing, rather than in a manner and on a timetable set by foreign politicians.

Intervention to hold down the renminbi, necessitating huge operations to sterilise foreign exchange inflows to prevent an unhealthy rise in money supply and a further build-up of inflationary pressures, is an enormously complicating factor in Chinese monetary policy. And, as we all know from the very vibrant trans-Atlantic debate that has sprung up on this in recent weeks, this is a matter for politics, not just economics.

It is not clear how much of the unprecedented build-up of Chinese foreign exchange reserves in recent years results from speculative inflows of short-term capital (which could flow out again if speculation a renminbi revaluation ebbs) and how much of it is due to genuine trade transactions. More research work needs to be done on this.

I must say however the Americans – particularly the politicians in Congress over whom the administration in Washington does not have a much control – are behaving somewhat childishly over this important question. What we have seen lately, in the American campaign to have the Chinese labelled as “manipulators” of the currency, is the politics of the school playground rather than of the superpower. Adopting the politics of name-calling and finger-pointing does not seem the right way of resolving this dispute and indeed may hamper opportunities of reaching a settlement.

The reasons for the big rise in Chinese monetary reserves include a build-up of trade leads and lags of the sort that we saw in the old days before the break-up of the Bretton Woods system in the early 1970s. We are seeing a tendency for Chinese companies to transfer dollar export proceeds very rapidly into renminbi at local banks in a way that causes a dollar shortage on the Chinese market and has negative side-effects. Inflows sparked off by speculation of a renminbi revaluation are encouraged by foreign political pressure and press comment, in a way that can be self-feeding. Numerous statements by People’s Bank of China Governor Zhou on the prospects eventually for a shift in the policy of pegging the renminbi the dollar, although meant to calm down the situation, have frequently been counterproductive by encouraging precisely the opposite outcome. Certainly the People’s Bank needs to pay attention to its international communications policy and will need to articulate for international consumption a much more thoughtful, cohesive and comprehensible policy on the renminbi. This is a very important challenge for the central bank, and one where we would all like to see progress in coming months.

IV

In the meantime, while a better over-arching policy framework is perhaps being constructed and then communicated, we can look to important smaller-scale steps in Chinese policies that will themselves, over time, drive healthy liberalisation and internationalisation of policies governing the renminbi.

- There are modest steps afoot to encourage central banks in Asia and further afield to hold renminbi in their foreign exchange reserves. These are practical measures to promote a move away from undue international dominance of the dollar and towards a genuine multi-currency reserve asset system.

- We see an increase in renminbi use in bond issues in Hong Kong – a reminder that the Chinese currency is becoming a greater force on world capital markets.
- Use of the renminbi in payment for internationally-traded raw materials is being stepped up. Perhaps we will even see a move over time towards the Chinese currency playing a role in a basket of currencies used for oil pricing, or indeed in a redefinition of the Special Drawing Rights that could be used not just for monetary transactions but also for payment and settlement of commodities.
- In economic research, it would be good to examine the extent to which Chinese export statistics are distorted by capital account transactions, e.g. where part of the recorded increase in Chinese exports is in lieu of capital account transactions, such as import of capital for investment in subsidiaries of overseas companies.
- There will be a move towards greater reliance on market forces in policies setting Chinese official interest rates.

There are several reasons for an eventual move towards greater flexibility on the renminbi exchange rate policy. But the desire to rebalance the trade flows between China and the rest of the world, and most importantly the US, is not one of the most important. The four reasons to which we should pay most attention are:

- The desire to create a more internationally-traded renminbi as a force on international capital markets, helping promote investment in the Chinese economy
- The growth of consumerism: a rise in the renminbi will improve China's terms of trade with the rest of the world by giving Chinese consumers more for their money – a development which, as we have seen in Germany after the Second World war with the progressive appreciation of the Deutsche Mark, ends up by making the population richer.
- A move for the Chinese authorities to regain control over the money supply and over policies to ward off inflation. We must never forget that inflation is a tax on the poor far more than the rich, and therefore is politically and economically divisive and disruptive.
- The wish to drive forward policies on regional integration by making use of the renminbi in trade, investment and financing throughout Asia, particularly in channelling Asian savings away from the west and towards large-scale development of Asian infrastructure in the next decade.

All these are more important than policies designed to correct China-US trade flows. Experience with the repeated appreciation of the Deutsche Mark after 1945 anyway shows that exchange rate rises do not work through very smoothly or quickly in correcting trade imbalances and can – by cheapening imports – even have the initial effect of boosting the trade surplus of the country that appreciates its currency.

In concluding, I'd like to leave you with three points.

First, the deregulation of Chinese banking and finance is a matter not just for China but for the world.

Second, the gradual internationalisation of the renminbi is part of the reforging of a genuine Asian capital market and a reflow of savings away from western markets towards investment in Asia. This is move that many in the West (by asking for an end to the Asian "savings glut") have called for, but will in fact end up increasing European and American interest rates as Asian money is redirected away from western bond markets.

Third, there will be equivalence, more than in the past, between financial power and political power. Of course, this is not completely linear. China is likely to be the No.1 economy in terms of GDP in the next 20 years – quicker if the renminbi is more rapidly revalued – but this does not mean that the US will no longer be the most powerful country from an overall geostrategic point of view. We must not forget that, back in 1820, the UK was the most powerful country in the world with a GDP only one-third of India's and one fifth of China's – and also, interestingly enough, with a GDP per capita that was only three times larger than that in each Asian country, much less than the wealth disparities we see today.

We used to say that rich countries required strong armies. Today, when military forces are still important but where, as a result of globalisation, so much – whether land, nuclear power stations or perhaps even countries - can be bought and sold on financial markets, we might say that rich (and poor) countries require strong banks.

To put this in the language not only of retail banking but also of sustainable economics: mobilising the messages no longer requires people to go on long marches through the countryside or to join the army in huge numbers. Rather it means taking consumers on a journey to exploit their buying power, in harmony with the needs of the people and the country, and in symbiosis with the environmental requirements of the planet.

Oscar Wilde, the Dublin-born dramatist, used to say somewhat disparagingly – in reference to the mercantilist trading spirit of the English – that English people knew the price of everything and the value of nothing.

The Chinese, as result of their growing financial and also political power, and their ability to carry out trade and investment on far-flung world markets, certainly know the price of everything too. But I believe that you also have the standards and the historical background resulting from thousands of years of civilisation to be able to use this power in a wise and responsible way. So let us agree that the Chinese people have the opportunity of knowing not only the price of everything, but also the value of everything too. And let this be not simply China's guide to its own development, but also a very important gift that China can bestow on the world.