Currency Internationalisation and the Canadian Renminbi Hub:

Context and Opportunities for Vancouver




VANCOUVER
ECONOMIC COMMISSION

Prepared for the Vancouver Economic Commission by:

Grégoire-François Legault (UBC) and Hatty Liu (McGill)

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Foreword

On behalf of the Vancouver Economic Commission (VEC), I am pleased to present this report on the prospects of the internationalization of the renminbi (RMB) currency. This paper puts a particular focus on the establishment of an RMB hub here in Canada. It reviews both historical context as well as recent developments and pulls together relevant findings and conclusions for anyone interested in the topic.

Vancouver is advantageously positioned as Canada's Asia Pacific Gateway, and the VEC sees tremendous opportunity to further leverage this advantage as growth in trade with Asia, driven primarily by China, continues to outpace other regions. Facilitating the settlement of these transactions in RMB via a local hub would provide additional incentive for Chinese companies to do business here, and likewise provide a competitive edge for local companies accessing Asian markets.

I hope you will find value in the information presented here, and I welcome and encourage an ongoing dialogue on the range of opportunities presented within this timely report.

Thank you,

Ian G. McKay

CEO, the Vancouver Economic Commission

Key Points

The following are key facts and figures related to the internationalization of the RMB, Canada's role in the RMB internationalization process, and Vancouver's role in the Canadian-Pacific regional economy. These are presented here as a condensed primer on the topics covered in the report, while the remainder of the document provides additional detail, context and analysis.

The internationalization of the renminbi (RMB)

- By 2015, about 30% of China's cross-border trade is expected to be settled in RMB, vaulting it from the 7th to 3rd most used currency in global trading behind only the U.S. dollar and euro. [1]
- In 2013, close to 20% of China's trade settlement was in RMB, up from nearly none, as recently as 2009.[2]
- More than 5.16 trillion RMB worth of payments was settled using China's currency in 2013. This represents an increase of 61% between 2012 and 2013.[3]
- More than 25% of China's inward and outward FDI flows are denominated and settled in RMB.[4]
- There were 900 financial institutions conducting business in RMB in 2011. The number is now more than 10,000. Now that the program has been expanded to the whole country, thousands of companies in mainland China are eligible to settle trade in RMB.[5]
- The Chinese government is committed to pursuing financial reforms, including the opening of the capital account. Unless delayed by a major shock of a scale similar to the 2008 Financial Crisis, reforms should be implemented by 2020 or earlier.
- The offshore RMB bond market has doubled in size each year since 2008. The issuance of RMB-denominated bonds, which started in 2007, rapidly grew to almost US$ 7 billion in 2012. However, the share of all international debt securities denominated in RMB remains low, at 0.3% of the world's total.[6]
- There are more than US$ 100 billion in RMB deposits in Hong Kong, representing close to 10% of all bank deposits in the special administrative region.[7]
- RMB payments in the United States surged by 327% between April 2013 and April 2014, placing Canada's neighbour in third position after Singapore and the UK, from 1.3% to 2.6% of the global total of RMB payments. This development took place despite the fact

that no official hub exists in the United States.[8] The RMB is already the world's second most used currency in trade finance.[9]

- The RMB accounts for 4% of global issuance of letters of credits for trade-related purposes, making the third most important currency of denomination for such credits.[10]
- The RMB is involved in 2.2% of global foreign exchange transactions, up from 0.9% in 2010.[11]
- A number of central banks and sovereign wealth funds have diversified or announced plans to diversify their holdings to include RMB reserves and investments. The central banks include Austria, Australia, Brazil, Indonesia, Malaysia, Korea, Thailand, Pakistan, South Africa, Venezuela, Nigeria, Hong Kong and Macao.[12]
- If the RMB moves toward full convertibility, it could become one of the currencies used in the IMF's Standard Drawing Rights (SDR) basket after the next revision in 2015. The SDR basket currently consists of four major currencies: the euro, the pound sterling, the Japanese yen and the U.S. dollar.[13]
- While there is a good liquidity in the RMB spot, forward and swap markets, RMB interest rate swap and repurchase markets are still undeveloped. Corporate treasury managers therefore continue to use the U.S. dollar.
- Institutional inertia can hinder the adoption of a new international currency, even as the country of the incumbent currency loses its economic dominance. Businesses are accustomed to using the incumbent currency and the fixed costs that this incurs. Use of the new currency will become widespread only when its benefits become clear, and may accelerate once a threshold level of invoicing is reached.[14]
- An annual global client survey by HSBC Canada in 2013 indicated that 48% of respondents considered minimization of exchange risk to be the most important advantage to RMB trade settlement, while 46% had been asked to settle transactions in RMB by their business partners. According to the survey, 73% of businesses believed that RMB cross-border activity would increase in the next five years. Around 27% of businesses believed that it would increase more than 20%. However, Chinese businesses indicate that business partners' lack of willingness to settle transactions in RMB remains the biggest challenge to RMB cross-border activity. [15]
- The latest survey deployed by HSBC in April of 2014 found that only 5% of Canadian companies that do business with China settle transactions in RMB, the lowest of 11 countries surveyed, compared to 17% of American companies and 22% of companies on average globally. Around 55% percent of Chinese companies surveyed by HSBC were willing to offer discounts to foreign companies choosing to settle in RMB. Discounts

ranged from 0.7% to 5%. More than a third (37%) of these companies were willing to offer a discount of 3% or greater.[16]

- Businesses' lack of willingness to settle in RMB and lack of awareness of the benefits of RMB settlement are obstacles to RMB internationalization. In a survey of businesses in Australia in 2013, a significant proportion of both Chinese and Australian companies (58% and 32% respectively) said that uncooperative business partners were a major disadvantage to settling transactions in RMB.[17] Both Chinese and Australian businesses indicated that they would increase RMB settlement if their business partners were more knowledgeable about RMB settlements and more willing to request and accept RMB payments.[18]

Canada's role in the internationalization of the RMB

- Canada-China bilateral trade increased by 4.5% in 2013, reaching 73.2 billion Canadian dollars, representing close to 8% of Canada's total trade.[19] At current growth rates, Canadian exports to China could surpass exports to the United States by the mid-2030s.
- Trade settled in RMB rose by 50% in Canada from 0.1% in 2012 to 0.2% in 2013. This is still extremely low compared to the United States and Australia, despite the fact the U.S. has not formally announced its intention to become an offshore RMB centre and Australia began to formalize its RMB trade only recently in July of 2014.
- In 2013, British Columbia became the first foreign government to issue dim sum bonds, which are offshore bonds denominated in RMB.[20] The provinces of Saskatchewan and Alberta have been watching B.C.'s move closely, and may follow suit in the near future.
- Having announced its intention to become an RMB offshore centre, the Canadian government could next assist in finding a clearing bank from China, advocate for a swap agreement for added liquidity and direct Canadian dollar-RMB trading, and raise awareness of RMB-denominated trade both in Canada and China.
- A few Canadian and foreign banks have a limited capacity to clear transactions in RMB. The volume of RMB transactions in Canada reached 15 billion in 2013.[21] For the moment, clients using the RMB in Canada remain rare.
- The Bank of China (BOC) has been the most proactive Chinese financial institution to push for the establishment of an RMB hub in Canada and advocate becoming the official clearing bank. Considering their ties and long presence in Canada, the BOC would be a partner of choice on the establishment of any new settlement centre. However, Industrial and Commercial Bank of China (ICBC), China Construction Bank, and the Agricultural Bank of China have also expressed interest in serving as RMB clearing banks in Canada.

- Of all the Canadian banks, Bank of Montreal appears to have been the most proactive on the RMB file. HSBC, with Canadian headquarters in Vancouver, has also worked to advance the RMB issue in Canada.
- The Department of Finance of Canada appears increasingly committed to seeing Canada become an RMB hub. Several rounds of meetings have been held in China and in Canada, with more to follow over the summer and fall of 2014.
- A swap agreement is not a technical prerequisite for Canada to become an RMB hub, but it is still viewed as a necessary step, as it would demonstrate the country's political commitment to the process.
- The Chinese ambassador to Canada has extended an invitation to Prime Minister Harper to attend the APEC summit this fall, where he could have an opportunity to announce federal government's support for establishing a hub in Canada and even a bilateral swap should the Bank of Canada agree.[22]

Vancouver's position in the Canadian-Pacific regional economy

- Vancouver has a competitive advantage as Canada's gateway city to the Pacific. This advantage includes not only geographic proximity to the Asia-Pacific, but also a well-developed transportation infrastructure with significant traffic to and from Asia, as well as a highly multicultural population.
- According to the 2011 Census, around 30% of the population of Vancouver CMA (668,300 out of 2,313,328) listed their ethnic origin as East or Southeast Asian. The percentage of Chinese-origin individuals in the population is 18.2%. According to the 2011 National Household Survey, 15% of the Vancouver CMA population declares Chinese as their first language, including respondents who selected multiple languages.[23] These proportions are higher than those of any other city in Canada.
- According to a 2014 survey by the Asia Pacific Foundation (APF), B.C. led every other province in Canada for the percentage of the population that favoured strengthening economic ties with Asia, considered Asian countries to be important to Canada's prosperity and saw Canada as being part of the Asia-Pacific region. On the whole, Canadian opinions on these matters have become significantly less favourable than in 2013, which was already less favourable than 2012. For the most part, opinions in B.C. have not fallen as far as they have in other provinces, such as Ontario.[24]
- The ports of British Columbia (Vancouver and Prince Rupert) boast the shortest sailing distance between Asia and North America, up to one day shorter than the next closest

North American port. Port Metro Vancouver is Canada’s largest and most diversified port, maintaining trade contacts with more than 160 economies around the world.[25]

- In 2013, China was the top principal trading economy for Port Metro Vancouver for both inbound and outbound shipment, as determined by the metric tonnes shipped of all kinds of cargo combined. Japan and South Korea took the second and third place. As of 2013 BC shipments heading to Asia account for 44% of BC’s trade, compared to 46% heading to the United States.[26] It is not difficult to imagine trade with Asia displacing those of traditional markets for Western Canada in the relatively near future.
- The Vancouver International Airport (YVR), consistently ranked as the top airport in North America, is the second busiest airport in Canada. Starting from 1995, flights connecting to the Asia-Pacific have accounted for more than 50% of all transnational flights at YVR each year. Air traffic to the Asia-Pacific grew by 4.9% from 2012 to 2013 and 19.8% for traffic to China alone. In the summer of 2013, all Mainland China-based airlines serving YVR added frequency to flights to and from Chinese destinations, making YVR’s weekly number of flights to China greater than any other airport in North America. [27]
- The Canadian head offices of HSBC are in Vancouver. BOC-Canada is headquartered in Toronto but has branch offices in Vancouver, while the Canadian representative office of the Agricultural Bank of China is also located in Vancouver.
- There is longstanding interest in having Vancouver become Canada's economic and social gateway to the Pacific. Since the late 1970s-1980s, federal, provincial, and municipal governments and various private actors have initiated or participated in projects designed to strengthen and leverage Vancouver’s competitive advantage in this area.
- Existing Pacific gateway initiatives have also been criticized as being too passive. Critics of these initiatives feel that they largely aim to reinforce existing advantages, and are lacking an innovative or long view perspective on how to employ these advantages strategically toward future growth in Vancouver and Canada.

Introduction

Meet the “redback,” the world’s next international currency. In 2013, China’s *renminbi* (RMB), also known as the redback or the “yuan,” became one of the world’s top 10 most used currencies. By 2020, it will be widely used in international trade and finance. Canada, and Vancouver especially, has been positioning itself for this transformation. In the five short years since China began its experiment in cross-border RMB trade settlement, five cities have become offshore trading hubs: Hong Kong, Taipei, Singapore, London and Frankfurt. The Canadian Department of Finance has initiated talks with the Chinese government on the possibility of establishing an offshore RMB settlement hub in Canada. Other cities in North America and Europe are also preparing similar initiatives.

The rise of an international currency is a highly complex process. It can be completed at varying speeds based on market forces and government policy. In the case of China, its approach to currency internationalization is marked by pragmatic inclinations: China has begun to promote the use of the RMB in settling foreign trade and in cross-border investment, and to establish offshore RMB centres, all of which simplify and facilitate these transactions from their perspective. Additional developments in China and abroad will continue to accelerate the pace of internationalization. Given the catalytic role that financial services play in the broader economy, it is expected that the Chinese leadership will be strongly motivated to push forward reforms in the hope of seeing Shanghai rival other financial centres like New York and Hong Kong. In the present context, it would not be surprising for the RMB to emerge as an international currency, and even possibly a reserve currency, much sooner than anticipated. In the remainder of this report, we will explore the context of the RMB’s phenomenal rise and what Canada and Vancouver can do to capitalize on the related opportunities.

Defining RMB Internationalization

A national currency becomes internationalized when domestic and foreign market participants use it to conduct economic and financial activity such as trade, investment and offshore invoicing.[28] An international currency has three basic functions: to act as a store value, a medium of exchange and a unit of account. It can be used by both private and public actors. The possession of an international currency confers several advantages to a country, such as:

- Minimization of foreign exchange risk;
- Allowing both parties to a transaction to lower their costs;
- Increasing the efficiency of borrowing for financial institutions;
- Removing the need for a given country to hold a large reserve of another international currency as a medium of exchange and a store value; and
- Symbolizing the robustness and resilience of an economy.

Trade contracts stand to benefit particularly from the minimization of exchange risk, as payments typically become due only after the initial order of goods. The internationalization of the RMB would allow China to reduce its reliance on the U.S. dollar, and serve as a potent form of China's soft power commensurate to its status as the largest economy, on purchasing power parity (PPP) basis.[29]

Historically, the rise of one country's currency on the international stage has corresponded with the fall of another country's economic power.[30] However, it is possible for a currency to achieve international status quickly despite there being an incumbent international currency as long as policymakers are willing to promote internationalization. The adoption of new international currencies is also frequently hindered by institutional inertia. On the eve of World War I, the U.S. dollar, like the yuan today, played an almost negligible role in international trade and payments.[31] This is despite the fact that the United States had become the world's biggest trading nation, like China today. Almost no bonds were denominated in U.S. dollars, even though Washington had become a net exporter of capital after 1890. However, partly due to the consequences of the war, the dollar became the world's leading international and reserve currency in a span of under 10 years. The internationalization of the Deutsche mark in 1973-90 and the yen in 1984-91 also bear similarities to the current situation of the RMB.[32] In all three cases, internationalization occurred as an unintended consequence of financial and economic expansion.[33]

China possesses the right economic and market size to see the RMB become an international currency. In 2010, China's GDP reached US$ 5.9 trillion. This effectively ended Japan's four-decade long reign as the world's second largest economy. China's GDP in 2013 reached US$ 9.29 trillion, while the GDP of the United States was US$ 16.72 trillion. Once purchasing power is accounted for, the gap between China and the US is closing even faster. Indeed, Beijing could become the world's largest economy by the end of the year. According to the IMF, China has already surpassed the American economy on a PPP basis.[34] China's foreign exchange reserves in May 2014 rose to a record high of US$ 4 trillion, or roughly 40% of its GDP. In terms of confidence in the currency, China's economic growth is still robust at 7.5%, inflation is relatively low, and the RMB has been appreciating slowly since the early 2000s.

For the time being, China's financial markets remain the weakest link in the internationalization process of the RMB. While it is hard to quantify depth, openness and liquidity, Chinese markets are less developed and mature than those of other countries of its significance. The trade in RMB in global foreign exchange markets has increased sharply over the last few years, but remains small compared to the overall size of the Chinese economy. The RMB's international usage lags notably behind Beijing's economic status as the world's biggest creditor, one of the world's largest economies and a leading trading nation.[35]

Process of Internationalization

The origins of the internationalization of the RMB

Prior to the Asian Financial Crisis of 1997, Beijing had been moving toward financial reform. In China, economic reforms are triggered by Five Year Plans. In 1994, the leadership had announced its intention to implement a market-based floating exchange rate that allowed the yuan to float within a band. In order to achieve membership in the World Trade Organization (WTO), the People's Bank of China (PBoC) also announced that the redback would be fully convertible by the end of 1996, or the beginning of the Ninth Five Year Plan. However, the schedule for full convertibility was abandoned in 1997.

The speculative attacks on currencies during the Asian Financial Crisis and the contents of the IMF rescue packages led to resentment across Asia toward Western-dominated international financial institutions. The Japan-led Chiang Mai Initiative aimed to provide Asia with its own institutional response to currency crises by giving greater access to foreign currency to its nations' central banks.[36] This pushed China to sign its first currency swaps with Asian countries between 2001 and 2004, demonstrating Beijing's interest in maintain economic stability at home and regionally while increasing Asia's independence vis-à-vis Western dominated international financial institutions. In 2005, at the eve of the 11th Five Year Plan, the leadership decided to restart the convertibility process. However, the 2008 financial crisis put the currency internationalization process on hold once more.

The 2008 global financial crisis threatened China's growth as it caused demand to fall dramatically around the globe. It also served as a wake-up call for the PBoC, causing it to realize that it was dangerous to hold around 60% of its then-$3 trillion foreign exchange reserves in U.S. dollars.[37] Furthermore, the collapse in dollar-denominated trade credit was a major motivating force, as Chinese policymakers started to question whether the U.S. dollar was a credible international currency. A new monetary system that includes the RMB and other important currencies would improve the existing international monetary system by providing both more flexibility and stability. Considering the dissatisfaction in China with the current international monetary system, the dominance of the greenback, and China's large exposure to dollar-denominated assets, it is not surprising that the Chinese leadership sees benefit in the yuan's internationalization.

Bilateral swap agreements

The PBoC has signed bilateral swap agreements with 24 countries, with a total value of more than RMB 2.5 trillion.[38] Bilateral swap agreements are natural extensions of existing contracts such as preferential trade agreements and bilateral investment treaties. Swap arrangements enable China to make its currency available in partner economies while maintaining control over the use of its currency outside its national borders. Bilateral swap agreements are not a prerequisite to establish an RMB hub, but part of the necessary financial architecture to support them. In addition, swaps can be viewed as political statements by countries demonstrating their willingness to act as hubs.

There is a strong demand for the redback outside of China. Many countries, especially in Asia and emerging markets, are dependent economically on China and would prefer to settle payments in RMB rather than U.S dollars. As a result of this market adjustment in supply and demand, the current bilateral swap agreements may accelerate the RMB internationalization process. However, empirical observation shows that swap lines have not been the biggest historical drivers of currency internationalization. While swaps have grabbed media attention, importers and exporters play a much bigger role in the process. Nevertheless, they are part of the financial infrastructure required to support the liquidity of the RMB.

Securities

In 2007, the Chinese government started an experiment in issuing bonds denominated in RMB in the offshore Hong Kong market. This effectively created market segmentation or a "firewall" between the onshore RMB market (CNY) and the offshore RMB debt market (CNH). Beijing wants to encourage foreign investors and nations to hold RMB-denominated assets. Accordingly, Hong-Kong and other offshore markets are a key component of China's strategy. The offshore CNH market is expected to grow by 30% each year and be worth US$500 billion by 2020.[39]

Trade settlements denominated in RMB

The RMB cross-border trade settlement scheme in China covers the whole country under a one-currency, two-systems mechanism (CNY and CNH). RMB cross-border settlements are rapidly increasing. While there was virtually no such settlement carried out in 2009, it has risen to 20% of China's trade in 2013. Close to 30% of China's international trade will be denominated in yuan by 2015, valuing more than US$ 3 trillion.[40] Settlements have been gaining traction in recent years because settlements denominated in yuan allow foreign companies and their Chinese partners to lower foreign exchange risk, as well as lower transaction costs and process payments more quickly. However, it should be noted that most of the risk reduction is passed on to the Chinese companies, since they have the advantage of dealing in their local currency. This rapid growth can also be attributed to the recent establishment of clearing banks in Hong Kong, Singapore, Taiwan and London, as well as the creation of RMB centres in several other cities.

Offshore RMB hubs

Offshore settlement centres and hubs exist to make domestic markets more open to foreign actors, and to help investment flow outward with an increased ease. In the case of China, their core functions are to facilitate trade denominated in RMB and to offer financial services also denominated in yuan. Publications often refer to cities where RMB transactions are processed as offshore RMB "centres" and "hubs" interchangeably. These centres or hubs qualified as "official" or "unofficial" to indicate whether they have authorization from China’s central bank to complete the transaction. New York, for instance, is an unofficial hub because its banks do not complete RMB transactions themselves, but rather serve as access points to hubs such as Hong Kong, where the transaction is actually processed. To differentiate, this report uses “hub” only to refer to official hubs while all other cities that handle RMB clearing will be called “centres.” It is the title of official RMB “hub” that cities in Canada and around the world are currently racing to obtain.

There are three types of offshore RMB centres: trade-driven, finance-driven, and centres that are a combination of both. Taipei, Sydney and Frankfurt are trade-driven RMB centres. These centres have close investment and trade ties with China, which help them build up RMB liquidity. Finance-driven centres, such as Singapore and Luxembourg, have strong financial ties to mainland China. The centres’ dominance in the global financial sector and the offer of RMB financial products can help them attract offshore investors and funds. The last type of RMB centre has close ties with China in both trade and finance. These include Hong Kong, London and New York. The use of RMB has recently surged in the United States, despite there not being an official offshore centre in the country.[41] This makes the United States the world’s third largest RMB centre outside of China and Hong Kong, after Singapore and London.

Becoming an offshore hub and promoting the use of the RMB in Canada could improve Canada's status in the international finance industry, as well as encourage foreign subsidiaries to establish their headquarters for the Americas in Canada in order to have access to RMB-denominated financial products and services. Since China is slowly lifting restrictions on its capital account, the expanding pool of savings could be channelled into foreign markets. As such, in pursuing an offshore RMB hub, Canada has an opportunity to become a major destination for Chinese FDI, provided Canada positions itself strategically to seize the moment.

Current experiments and recent policy changes

Chinese leaders envision a specific role for the RMB, in which Beijing should responsibly reform its financial system while avoiding creating shocks in the international system. In 2006, the PBoC published a study entitled "The Timing, Path and Strategies of RMB Internationalization," which explained that it was time for China to loosen its grip on the redback. The paper argued that the internationalization of the RMB was inevitable and that an international currency would significantly enhance China's international status, its influence on the world economy, and its competitiveness.[42] China has since then opted for a dual-track strategy to promote the RMB.[43] The first track corresponds to the promotion of the RMB in the financial markets, and the second track to the increase of its use in trade and FDI.[44]

In 2011, at the beginning of the 12th Five Year Plan, the PBoC announced further steps to liberalize the RMB. It is likely that the 13th Five Year Plan scheduled for 2016 will coincide with the introduction of several more measures furthering financial reforms. However, the historical precedents demonstrate that financial reforms and the internationalization of the redback are not stand-alone issues. Both are intertwined with China's economic development and stability of global financial markets. More recent announcements made in 2013 indicated that the Chinese central bank will end normal intervention in the currency market and widen the redback's daily trading limit past the current 2% fluctuation band. Investment caps will also be phased out for both domestic and foreign investors. The current capital control mechanism will be scrapped when conditions are mature enough. In addition, a ceiling on deposit rates will eventually be removed. All these moves confirm China's desire to become a full-fledged market economy, albeit on its own terms and without a specific timeframe.

The offshore-centre approach is being actively managed by Beijing to advance the internationalization of the RMB. Multiple offshore centres are being developed by Chinese authorities to serve various regional markets, as well as to allow tapping into the comparative advantage of each centre. Thus, Hong Kong may be more suitable for commercial transactions with China, while London may play a greater role in investment finance and foreign currency exchange. Therefore, it is up to Canadian cities to find their own niche of expertise to provide services to Chinese companies trading with Canada, Chinese investors looking for new investment venues, as well as Canadians looking to settle trade denominated in RMB or looking to diversify their investment opportunities. Should Canada become the first American country to establish a hub, it could also act as a redback hub for companies with operations throughout the Americas.

The Shanghai Free-Trade Zone (FTZ) was launched in September 2013. The FTZ will have lower tariffs and other significant trade incentives comparable to or better than other free-trade areas in China. The Chinese leadership's aims to see Shanghai become a full-fledged international financial centre by 2020. This is also the tentative date set by the government by which the RMB will have achieved full convertibility with other currencies and China will have fully openness of its capital account. Thus, the Shanghai experiment can be understood as a test bed for further economic liberalization at the national level. In the FTZ, the markets will be able to set interest rates. Additionally, Chinese citizens and foreigners will be able to trade the redback freely, investors will be able to invest a stake into previously closed sectors such as telecommunications, foreign banks will be able to operate without having a Chinese partner and foreign companies will be able to participate in commodity futures trading. If the financial liberalization experiment currently underway proves to be conclusive, it may snowball into other reforms at the national level. Indeed, as the State Council seems to have had a critical say in the establishment of such a zone, the experiment in all likelihood was meant to coincide with the financial liberalization announcements made during the Third Plenum in November, 2013. This Shanghai experiment also suggests that China's global integration is no longer limited to foreign trade, but will soon also spill over to finance. Financial experiments are taking place or will soon start in at least a dozen other cities, including Tianjin, Guangzhou, Qianhai and Wenzhou.

Reserve currency and Standard Drawing Rights basket

Along with demand, which increases the volume of yuan-denominated settlements, foreign central banks are helping to speed up the process of RMB internationalization. Australia's central bank is the latest of these to have agreed to hold the redback as part of their exchange foreign reserves.[45] A number of central banks and sovereign wealth funds have diversified their holdings to include RMB reserves and investments, or at the very least plans to do so.[46] If the RMB becomes fully convertible, it should eventually become included in the International Monetary Fund (IMF) Standard Drawing Right (SDR) basket once China completes its financial reforms (i.e. capital account liberalization) and more banks start to hold a significant share of their reserves in RMB.

The SDR basket is the international reserve asset created by the IMF in 1969 to supplement its member countries' official reserves in times of need.[47] It is not a supranational currency, but can be exchanged for any freely traded one. Its value is determined by a basket of currencies which comprises the U.S. dollar, the yen, the euro and the pound sterling. The composition of the basket is reviewed on a rolling basis. During the 2010 review, the IMF touted the RMB as being worthy of inclusion in the basket.[48] However, the RMB's lack of convertibility prevented its accession to the basket at that time. Furthermore, since the RMB does not fulfill a reserve role, there is currently limited potential for it to be included in the SDR. This runs partly at odds to the fact that China is now one the most prominent countries in global trade. It is likely to become one of the currencies used in the basket after its next review in 2015, especially if the Chinese central government continues to implement several policies to encourage trade settlement in RMB-denominated assets and full convertibility. A broader use of the SDR as a supra-sovereign currency and a currency of last resort was among the several solutions that the governor of the PBoC suggested to avoid a repeat of the 2008 financial crisis.[49]

China is increasingly vocal in asking the IMF and other Western-led financial institutions to undertake major reforms reflecting the growing might and influence of developing economies. In parallel, Beijing is pushing for the creation of its own financial institutions in Asia to displace existing ones. The proposed Asian Infrastructure Investment Bank, capped at an initial investment of US$ 100 billion, would seek to create a new "silk route" to reconnect Asia to Europe by land. If it was established, this bank would directly rival the Japan-led Asian Development Bank capped at US$ 165 billion.

An Asia-Pacific RMB trading bloc

China could potentially first see its currency be widely traded in the Asia-Pacific before it becomes a global reserve currency. Indeed, Asia needs an alternative to the U.S. dollar for intra-Asian trade and finance due to the regional economic integration that is taking place.[50] The RMB thus far is the most viable option, since China is often the leading trade partner in the region, and the supply chains of the region are deeply interconnected. This emergence of an RMB trading bloc in Asia is likely and would precede the redback's accession to the status of global reserve currency.

Positive effects on global markets

An internationalized RMB will help increase the supply of global liquidity, and thereby further stabilize the current international monetary system. Since economic and financial conditions in the United States and China are imperfectly correlated, both countries should be able, and more importantly willing, to act as lender of last resort in case of financial shocks.[51] Furthermore, emerging economies are engaged in an increasing volume of trade, which forces them to accumulate U.S. dollars and finance America's deficit. In a multi-nodal international financial and monetary system, fewer countries will need to buy greenbacks. This will allow its exchange rate to adjust, and will have the effect of reducing the American chronic trade deficit and stabilizing the overall financial markets by giving it more latitude.[52] In sum, the global markets should become more resilient to shocks, provided China accepts to take on additional responsibilities commensurate to its newly acquired powers.

Risks associated with RMB internationalization

It is important to keep in mind that the internationalization of a currency is not a linear process. Though underway, the process could be reversed. The Chinese authorities have started to internationalize the yuan before pushing through comprehensive financial reforms that may be painful for Chinese SOEs. For now, the redback is crossing borders at a transitional stage in the country's financial development. The interest margin is highly regulated, lending is subject to quantitative guidance and foreign banks only play a marginal role in the Chinese economy. This has also led to the rise of a largely unregulated shadow banking system in China.[53] Inflows and outflows are still strictly controlled by the PBoC and the State Administration of Foreign Exchange under tightly managed quota systems such as Qualified Foreign Institutional Investor, Qualified Domestic Institutional Investor and Renminbi Qualified Foreign Institutional Investor.[54]

A new project is underway that will aim to establish mutual-order routing connectivity between the Hong Kong and Shanghai stock exchanges.[55] This will give investors outside of China access to a certain number of Shanghai stocks, while at the same time giving Chinese investors access to Hong Kong stocks. Cross-border financing is in its infant stage, and is mostly possible through the Qianhai pilot project aimed exclusively at Hong Kong banks. China will need to rebalance its growth away from an export-led model toward a consumption model, or else the RMB may never take off as an international currency. In order to become one, China will need to address all of these issues.

Thus far, China's growth rates have been sustainable due to the abundance of one of the three classical factors of production: labour. However, future growth can only be sustained by capitalizing on the last factor, that is, capital. In fact, as China pushes for internationalization, capital that is trapped in China will start to flow outwards. Interest rate volatility suggests that the credit system in China remains weak. All of these factors combined could cause the "people's currency" to depreciate. On the other hand, there may be pent up demand for Chinese assets from the rest of the world that would mitigate this effect.

The middle-income trap, such as when a nation's growth stagnates after reaching a middle-income level, is an additional risk that China faces.[56] A developing country at this income level is not yet ready to compete with advanced economies. However, wages will have risen enough that companies will start to relocate manufacturing to lower-wage economies in order to save on labour costs. The challenges posed by the middle-income trap are real, and to some extent, China has been experiencing it for several years.

The Chinese government also has to address several pressing issues, including: corruption, domestic debt, rehabilitation of the banking system, restructuring of non-performing SOEs, responding to and adequately addressing environmental problems, establishing a country-wide social safety net, rebalancing the economy and reforming the tax system. It will need to accomplish all this all of this at a time when millions of people are moving from rural to urban centres. These issues faced by China are immense. Each risk by itself is not enough to stop the internationalization of the redback, but combined together they could result in significant challenges.

Prospects for Canada

Opportunities and Risks for Canada in the RMB internationalization process

The internationalized RMB matters to Canada and Canadian companies because they stand to gain:

- Unrestricted offshore access to RMB trading, hedging and financing;
- Reduced supply chain costs;
- Increased bargaining power, more favourable and transparent pricing of goods;
- Lower transaction costs for foreign companies operating in China, or buying goods and services from China;
- Reduced barriers for business growth in China in the short and medium run;
- Greater investment choice and yield opportunities for offshore redback deposits in the medium and long run;
- Broader access to onshore buyers and suppliers;
- Reduced foreign exchange hedging costs for FDI and ODI;
- Ability to hedge RMB exposure;
- Diversified and competitive source of financing; and
- Eventual complete convertibility of a currency bound to continue appreciating.

The internationalization of the RMB is moving fast globally, with many recent developments. Taipei and Singapore won the rights to clear RMB in December 2012 and April 2013. [57] Also in 2013, working groups in Toronto reviewed plans to make the city first North American RMB hub in June, and the Mayor's Office of San Francisco met for preliminary talks with PBoC executives to the same end in September.[58] On June 18th and 19th, 2014, the PBoC designated the China Construction Bank in London and the Bank of China (BOC) in Frankfurt as official clearing banks for those hubs.[59] Switzerland's plans to establish a Swiss RMB hub, which was unveiled at around the same time as those of Britain and Germany in 2012, also appear to be moving along. The plans were discussed at a meeting between PBoC governor Zhou Xiaochuan and Swiss Finance Minister, Eveline Widmer-Schlumpf, in late June.[60] On June 29, 2014, the central banks of China and France signed a memorandum of understanding toward establishing an RMB payment system in Paris, a first step toward creating an RMB settlement hub. [61] Plans are also underway to establish an RMB clearing bank in Australia in the coming months.[62] New York is already an unofficial RMB centre. In all, business leaders and working groups in at least 12 cities have worked or are currently working on initiatives to promote their cities as RMB hub candidates. At least six of them joined the race in the past year, Vancouver and Toronto among them.[63] The U.K. has already begun its planned sale of dim sum bonds, thereby becoming the first country to issue RMB-denominated bonds.[64] The window of opportunity for Canada is closing rapidly.

Given the absence of an RMB hub in the Americas, RMB clearing and settlement is still a green field in Canada and the rest of the world. The internationalization of the RMB gives Canada the chance to solidify its position in the region and improve its ties with China. Indeed, the agenda of Canada-China relations is in dire need of a new guiding framework after many years of quasi Cold War politics.[65] China is Canada's second largest trading partner and its share of trade is expected to continue to grow.[66] Facilitated by the use of RMB, more Chinese investment and trade in Canada would likely follow. By utilizing the RMB, exporters and importers not only can reduce exchange rate risk, but can also use available financial products to hedge risk using the RMB. Network effects can be applied for currencies as well – that is to say, having a large number of hubs around the world should help to stabilize the redback. In the long run, Canada will be able to diversify risks and have access to additional sources of global liquidity other than USD-denominated products.

In June of 2014, Canada's Minister of Finance, the Honourable Joe Oliver, announced that talks are underway with the Chinese government on the topic of establishing an RMB trading hub in Canada.[67] However, the Department of Finance has issued no further statement as to the progress of these talks and their future proceedings. The Chinese government and Chinese banks have been comparatively more eager to establish a hub in Canada. Outside of China, there is a lack of awareness or willingness on the part of businesses to embrace RMB settlement. In a Centre for International Finance and Integration survey of businesses in Australia, both Chinese and Australian companies asserted uncooperative business partners to be a major disadvantage to settling transactions in RMB, and indicated that they would increase RMB settlement if their business partners were more willing or knowledgeable about this option.[68] The situation is similar in Canada, where the total number of clients using RMB is in the low thousands. A survey deployed by HSBC in April of 2014 found that only 5% of Canadian companies doing business with China settle their transactions in RMB, the lowest of 11 countries surveyed. The global average was 22%.[69] More than half of Chinese companies indicated that they would be willing to give a discount to foreign companies choosing to settle trade in RMB.[70] Banks may also have to accept some loss to help the RMB market in Canada grow. Around 37% of

Canadian companies indicated they plan to start settling transactions in RMB in the future, above the global average of 32%.[71]

According to the Toronto Financial Services Alliance (TFSA), the cost of operational changes from offering services in U.S. dollars to RMB is one of the concerns for the financial industry due to the potential lack of economies of scale since the level of liquidity demand in Canada remains low at the moment. However, as seen in the example of London, operational requirements of RMB liquidity and clearing capability for RMB products can be sourced through existing infrastructure like Hong Kong. The development of any new infrastructure could be explored only when the level of activities requires it in the medium to long term. In the long run, unless Canada meets with so much more demand from China's other large trading partners in the Americas, a full RMB product development potential may still be hard to realize. Nevertheless, finance follows trade; as trade continues to grow between the two countries, financial links between Canada and China should grow stronger.

Key developments

Compared to the likes of London and Frankfurt, Canadian cities have been relatively late entrants in the race for RMB hubs. However, the province of B.C. has led the global effort to increase the availability and diversity of offshore RMB services in other ways. In 2013, the provincial government became the first and largest foreign sovereign bond issuer in the CNH market.[72] Priced with a 2.25% interest rate, this one-year term dim sum bond was quickly oversubscribed. Nearly 60% of the investors were from Asia. Institutional investors in the United States made up the rest.[73] The issuing of the dim sum bond suggests that the provincial government believes the internationalization of the RMB is underway. Accordingly, the government recognized RMB denominated bonds as a means to diversify its investor base, access new sources of global liquidity, and increase financial and economic ties with China and the rest of Asia.[74] Other Canadian provinces, namely Alberta and Saskatchewan, are also considering issuing debt denominated in redback. If the hub proposal was to go ahead, and considering the bonds issued by B.C. were listed in Luxembourg, it is conceivable that future issuance of redback denominated securities could take place in Canada.

The TFSA has been spearheading an effort to discuss plans to make Toronto into an RMB hub with Chinese and Canadian banks since 2013. On June 2014, B.C. Minister of Finance Michael de Jong, told reporters that he planned to propose Vancouver as a location for the RMB hub alongside Toronto.[75] In late August, 2014, TSFA and AdvantageBC further announced that they would work together alongside federal and provincial officials and the finance industry to promote Canada as an RMB hub.[76] According to Minister de Jong, the working group is formulating toward a "pan-Canadian" approach that emphasizes Toronto and Vancouver's respective strengths as Canada's financial nerve centre and its gateway to the Pacific.[77] Which city will handle the settlement is yet to be determined. The aim of the working group, for now, is for Canada to formalize its bid as fast as possible. Competition between the two cities would leave room for cities in the United States or elsewhere in the Americas to join the race, while emphasis on each city's unique advantage strengthens the position of Canada on the whole.

However, though the two cities are currently working together, each city's part in the collaboration remains unclear, as is the question of which will host the exchange. Because an RMB hub is not necessarily a physical space, but rather an integral component of a virtual infrastructure within the existing financial structure, companies across Canada would have access to financial services denominated in yuan regardless of where the hub is hosted, though it can create jobs directly and indirectly in the host city. There would also be a certain amount of prestige tied to being named Canada's RMB hub, and it may be helpful for marketing purposes for Canada to have a clearly designated hub.

The China-Canada Economy and Finance Forum took place in Vancouver on June 6, 2014. RMB hub benefits, offshore RMB developments, and related trends in the Chinese economy were discussed. On the same day, an amendment to allow Schedule III banks to register in B.C.'s International Business Activity Program (IBA) was put to force. The advantages to setting up the hub in B.C. were also addressed, namely the province's historical connection to Asia, export of natural resources to China, and Vancouver's optimal location.[78] Bruce Flexman, then-President of AdvantageBC, said during the conference that settling trading in renminbi would increase bilateral trade by $500 million dollars per annum.

B.C.'s Minister of Finance, federal and Ontario officials and representatives of the TSFA convened in Ottawa on Aug. 5, 2014 to discuss how to construct an offshore RMB centre and expand RMB business in Canada. At the forum, BOC-Canada (BOCC) president Wang Lijun gave a keynote speech highlighting granting business licenses in the Canadian market to BOC and other foreign bank branches as a key step toward the expansion of RMB business.

Limited clearing capacity already exists in Canada among Canadian and foreign banks. However, only a handful of Canadian banks have so far expressed interest to offer additional services or financial instruments denominated in RMB, most likely due to low demand and poor knowledge. The Bank of Montreal appears to have been the most proactive Canadian domestic bank in this regard.[79] However, for now, international bank HSBC Canada is leading the charge. HSBC is already offering RMB services to more than a 1,000 clients, for a total value of a little more than 1 billion dollars[80]. Overall, the volume of RMB transactions in Canada is around 15 billion dollars.[81] In the case of BOC, RMB business volume in Canada has grown by 50% per year on average since inception. Canadian banks and insurers have formed a working group with several Chinese banks to work out the logistics of the trade infrastructure and convince the federal government that there is enough industry support and trade activity to support an offshore hub in Canada and sign a bilateral swap agreement.[82] The BOC, ICBC and Agricultural Bank of China had expressed interest in expanding their operations in B.C., beginning in 2011, when the amendment to the IBA had first been indicated. The latter two had explicit views to establish a Schedule III bank branch in the western province. The events of June 6 will likely move this process forward.[83]

Representatives of the Canadian Department of Finance met with their counterparts in the Chinese government in Beijing this past May. The establishment of an RMB hub was also likely on the agenda of the meeting of the Financial Sector Policy Dialogue in China that took place in October.[84] Moreover, the Department of Finance has announced intentions to pursue a swap agreement with the People's Bank of China (PBoC). However, the Bank of Canada's position is still undefined as the matter is now political. The Governor of the Bank of Canada, Stephen Poloz, recently commented on the state of the U.S. economy and the internationalization of the RMB during IMF meetings in Washington, stating that emerging markets now account for more than 50% of the global economy, and that much growth taking place in the U.S. was the result of relaxed monetary policy. Poloz also asserted that the internationalization of the RMB would improve trade by saving companies money in foreign exchange fees.[85] It may be possible that Bank of Canada is waiting for more trade to be settled in RMB before pursuing a swap agreement. Senior officials of the Bank met with the Secretary General of the PBoC's monetary policy committee in Aug. 15, 2014, to discuss RMB internationalization and business in Canada.

China's new ambassador to Canada, Luo Zhaohui, also voiced his support for the establishment of an RMB hub in Canada in an address given on June 8. Luo invited Prime Minister Harper to attend the 2014 Asia-Pacific Economic Cooperation (APEC) Leaders Meeting in Beijing in November.[86] Such a stage would provide the perfect opportunity for the Canadian government to announce a swap agreement, or at least officially endorse Canada's bid for the RMB hub.

Opportunities for Vancouver

Aside from taking initiative on the issue of dim sum bonds, the province of B.C. and the city of Vancouver have taken action to reinforce Canada's ties with China and the Pacific in numerous other ways. These have been outlined in greater detail in the executive summary. B.C.'s Pacific initiatives would appear to be a natural consequence of geographic and historical factors. B.C. is located on the Pacific Rim. Vancouver and several of other municipalities in its metropolitan area have been the province's major seaports and the landing site for most migrants entering Canada across the Pacific from the nineteenth century onward. Today, the ports and airports of B.C. facilitate tremendous amount of trade and migration between Asia and North America, and are in a position to increase the breadth and depth of their connection to Asian markets.[87] Vancouver also has an incredibly diverse population of Pacific Asian-origin individuals with facility in Asian languages and personal and cultural attachments to Asia.[88] B.C. has led every other province in Canada for several years running in Asia-Pacific Foundation surveys evaluating Canadians' warmth of feeling toward Asian countries and the idea of a Pacific regional system, as well as their receptiveness to increasing economic ties with Asia.[89] In addition, Vancouver is the location of the head and branch offices of the Canadian branches of several Chinese banks, and will likely welcome more Section III branches of Chinese banks in the near future following a recent amendment to the province's system of tax incentives for international business.

Beginning in the late 1970s, a number of development plans were issued by the federal, provincial and municipal levels with the aim of making Vancouver a "strategic city" of the Pacific Rim economy.[90] To that end, these "gateway initiatives" broadly aimed to reinforce Vancouver's natural and historical connection to the Pacific, as well as Canada's ties to the region by extension. Economic initiatives ranged from economic delegations to Asian cities to provincial tax incentives for international business. There was also a subset of initiatives that aimed to take Vancouver's role as Canada's Pacific Gateway beyond the economic level. These included sister city arrangements, post-secondary programs for international students, Asian language and social studies education at the K-12 and post-secondary levels, efforts to maintain contact with alumni and professional networks in the Asia-Pacific, and improvement of transportation infrastructure that connect the economies of the Asia-Pacific and North America through B.C.'s Lower Mainland.[91] Additionally, while the Federal Immigrant Investor Program (IIP) did not originate in or solely apply to B.C., it can also be considered a *de facto* gateway initiative due to the fact that Hong Kong investors destined for B.C. made up the overwhelming majority of program applicants in the first two decades of its existence, while affluent Chinese mainlanders similarly became dominant in the 2000s.[92]

In July 2014, the IIP and Federal Entrepreneur Program (EN) were terminated by the federal government. This was due to the recognition that the investor immigrant program as originally designed provided little tangible benefit to the Canadian economy, while the entrepreneur immigrant category had largely failed to bring in individuals with ability to lead or drive innovation. The government intends to replace the IIP with programs that will contribute to the Canadian economy more meaningfully. The replacement for the EN, the Start-Up Visa, was launched in April 2013. The re-evaluation of these programs signals a shift of priority toward a more purposeful form of job-creation, designed to promote innovation and productivity necessary for Canada to compete in a decentralized global economy.[93] B.C.'s International Business Activity Program was also amended in June 2014 to allowing foreign (Schedule III) banks to register in the program.[94] The IBA, which established in 1988 as the International Financial Activity Program, allowed corporations registered in the program to claim a full provincial tax refund for international business activities. Chinese banks that expressed interest when the amendment was first indicated in 2011 experienced uncertainty later when no action was taken.[95] With the amendment having gone into effect, the banks are now likely to establish Schedule III branches in Vancouver.

These recent changes are notable in light of several criticisms that Pacific Gateway initiatives have been subject to in the decades since their inception. Some of these initiatives have fulfilled original expectations, while others have fallen short. For instance, transportation improvements under the Asia-Pacific Gateway and Corridor Initiative (APGCI) have met many milestones as of 2010, and the Vancouver International Airport (YVR) has cemented itself as a major transportation hub for flights between North America and Asia, China in particular.[96] However, the IIP, education programs and initiatives promoting Vancouver's "social connections" to the Asia-Pacific are considered to be failing or, at best, difficult to assess.

Critics have stated that these so-called "soft" gateway initiatives rely on polishing Vancouver's existing connections to the Pacific and lack a strategic mandate to increase Vancouver's competitiveness as a destination for business among all the cities in the Pacific Rim. They further argue that measures aimed at creating or reinforcing Canada and Vancouver's Pacific ties are based upon superficially similar premises, with little consideration to questions such as how economic and educational initiatives could be made to support each other systematically, or how the movement of goods, knowledge and wealth across the Pacific fits into a long-term plan to promote strategic growth and continual business opportunity for all the economies involved.[97] For instance, critics observe that funds from the IIP in Vancouver went disproportionately into real-estate purchase and pre-planned construction "megaprojects" rather than to create opportunities for Canadians in trade, manufacturing or research. Recent statements made by the federal government upon the cancellation of this program confirm these observations.[98] Additionally, investors were deterred from living or establishing permanent offices in Vancouver due to the comparative difficulty of accessing resources and markets in Asia, the government's lack of attention on the social needs of immigrant-investors and tensions resulting by their impact on the urban community of the Lower Mainland, and a program structure that permitted – and to an extent, encouraged – migrants to maintain significant business networks and fixed capital investments in Asia.[99]

Social scientists have observed that international alumni in B.C. are given little direction as to how their socialization can benefit the economic development of the province. Whether international students returning to Asia after their studies in B.C., or Canadian alumni residing in the Asia-Pacific are thought to be best positioned for this task, is also unclear.[100] In addition, Chinese-Canadian business associations have indicated that many of their members prefer to conduct business through Asian cities, where they find considerably more opportunity to apply their particular skills and background.[101] Likewise, the number of language programs has declined since the 1990s due to perceptions that students lack opportunity to apply their language education in the province.[102]Even "hard" gateway initiatives are not immune from issues of community disengagement. A survey deployed on behalf of the Asia-Pacific Gateway and Corridor Initiative (APGCI) in 2009 showed that while residents of the Lower Mainland supported the development of a Pacific Gateway and the attendant economic growth in the region, few recognized that these objectives were already being carried out by the APGCI. Many who witnessed the implementation of APGCI projects in their neighbourhoods were unaware of their policy background and purpose. Respondents also expressed being confused by the plethora of public and private projects that have seem to have fallen under the "Pacific Gateway" heading. [103] The outcome of these studies indicates that in order to substantiate its brand as Canada's gateway to Asia, Vancouver, and by extension B.C., needs strategic developments.

Developments such as the closure of the IIP, amendment to IBA, and issuing of dim sum bonds indicate that the Province is willing to review the success of gateway initiatives with providing depth and long-term growth to the Canadian economy. They also demonstrate a commitment on the part of the government to assess why certain initiatives fail, and how they can be remade to support the Canada's competitive position in light of changes in the global economy. The establishment of Vancouver as an RMB hub would represent an important step toward the consolidation of this new strategic outlook. The lowering of transaction costs has the direct consequence of putting Vancouver on the map for both Canadian and Chinese businesses as an advantageous place to locate commercial activities with China. As capital controls are slowly lifted in China, a large amount of domestic savings currently trapped in China could be invested abroad in the next few years. Chinese investors are likely to be drawn by higher interest rates and return on investments abroad, especially when factoring relatively low domestic interest rate inflation. In this context, reinforcing B.C.'s financial links with China could help the province finance the exploration and development of the province's natural resources, particularly natural gas.

At present, Vancouver offer advantages such as outstanding liveability, geographic location, world-class transportation facilities, existing business and cultural connections with China, and myriad lifestyle amenities such as a multicultural and progressive population. The city also has a bourgeoning specialization in green technology and environmental services, and an overall start-up ecosystem that ranks 9th in the world.[104] These are conditions that tend to attract international talent as well as high value-added industries and business services to a city. However, the fact remains that transnationally-minded businesses, by definition, have a whole world of possible business locations. There are other cities in the Pacific region that can offer unique advantages such as a better-known producer service sector and more mature connections to the global financial system. To compete, Vancouver needs to improve its case by further strengthening a business environment that supports the key sectors it aspires to host, maximizes the professional resources it has, and creates sufficient opportunity to encourage both industry and talent to stay in the city and grow.

As Canada and China have initiated talks on the Canadian RMB hub, Vancouver now has the potential to become the first offshore RMB hub of the Americas. As such, it would also be able to attract business activities from the rest of the Americas and Asia that require a steady supply of RMB, Canadian dollars, U.S. dollars, as well as the city's shipping facilities and other business amenities. In addition, there will be a demand for skilled professionals to work in banks, likely leading to export-related services involving high-level information processing including trade finance, fund management and financial advising, and various auxiliary services in the legal and other sectors to support the branch and head offices functions of banks or businesses that relocate to Vancouver.[105] Even if Toronto becomes the site where the actual exchange takes place, increased trade and settlement brought on by the hub will nonetheless create additional demand for Vancouver's port, transportation, and banking services. The province would be able to access new sources of investment for natural resources development. This is a high priority item on B.C.'s government agenda as the export of natural resources forms a major part of B.C.'s trade with China, the United States and the rest of the Asia-Pacific region. Businesses across other key sectors for Vancouver such as technology, the digital entertainment and interactive industry, and green economies would also benefit from an increasingly advantageous trade and investment relationship with China. Canada-China bilateral trade reached 73.2 billion Canadian dollars in 2013, representing close to 8% of Canada's total trade and an increased by 4.5% from the dollar amount of the previous year.[106] At these same growth rates, Canadian exports to China could surpass that of the United States at some point in the mid-2030s.

In summary, Canada can best prepare for the future Pacific economy with Vancouver as an RMB hub. Canada may still be focusing on its southern and traditional European allies, but the geopolitical momentum is shifting toward Asia. By the same token, becoming an RMB hub represents a good opportunity for Vancouver because in comparison to the gateway initiatives previously described, this measure has the potential to make the fullest and most systematic use of Vancouver's existing advantages such as its infrastructure for finance and trade, human capital, and cross-continental business and social connections. Additionally, it would use these resources in such a way that creates increased demand for these resources in turn. This gives investors or professionals with interest and expertise in Asia a reason stay in Vancouver, as they will be able to find continuous opportunity to apply their talents and grow their careers or investments optimally. By allowing Vancouver to develop a specialized and sought-after service offering for the global economy, the RMB hub would open the way for Vancouver to achieve true strategic importance to the transnational Pacific economy and become a more meaningful, genuine Pacific Gateway for Canada. This is a well-trodden avenue by which regional urban centres in the world economy attain global city status, substantiated by the examples of Sydney, Zurich, Rotterdam, California's Silicon Valley, and a plethora of other cities and urban regions that emerged as transnational central places in the later twentieth century.[107]

RMB internationalization and the Canadian hub: what to expect

The world's largest banks believe that the use of RMB as a trading, investment and reserve currency will continue to grow. By 2015, RMB trade settlement will have surged, particularly among its main trading partners. The redback's role in global trade cycle should also be reinforced. By 2020, the RMB should be prevalent in finance and be fully convertible.

The position among Chinese banks is that the internationalization of the RMB affords China a unique chance to make history and take a position of leadership on an international stage. Banks that have released statements on the subject – namely BOC, ICBC, Agricultural Bank and HSBC – have identified the RMB's stability in the face of both the 1997 and 2008 financial crises as its chief attraction for commercial actors.[108] This enables the RMB to potentially act both a stabilizing mechanism from the global financial system and as safe harbour from exchange risk. As such, BOC is hopeful that the internationalization of RMB will lead the international financial system toward a historic paradigm shift away from the use of a single national currency as reserve currency.[109] The Triffin Paradox resulting from this situation had been named by the PBoC in 2009 as the root cause of the 2008 crisis, months before China launched its pilot program for cross-border RMB trade settlement.[110] In addition, according to HSBC, a second major reason why businesses adopt RMB settlement is the pressure to do so from business partners.[111]

The BOC considers commercial banking to be a major driving force behind RMB internationalization.[112] According to the CEO of the BOC, Tian Liguo, the following are the actions that banks must take to support the internationalization process:

1. To provide RMB products and services well-suited to the needs of clients inside and outside China, in order to increase the use of RMB in cross-border trade and offshore investment; to deepen relationships with importers, exporters, and global clearing houses in order to promote RMB clearing and settlement for bulk transactions.
2. To promote the development of an infrastructure to support offshore RMB markets, with a view toward establishing a global network of RMB clearing activity.
3. To continually create new offshore RMB financing products; to foster the markets for foreign exchange, bonds-issue and investment; to promote the deepening of financial markets in order so that the RMB becomes an actively exchanged currency in various offshore markets and so that offshore markets become sustainable carriers of RMB; to utilize market forces to gradually close the distance between onshore and offshore markets.

4. To foster a more reasonable RMB pricing system and mechanism, and provide clients with effective strategies to manage liquidity and exchange risk.

The BOC also asserts that it is willing to utilize existing global clearing and trade systems in order to open a path for the RMB toward offshore clearing. For the most part, banks are optimistic that the renminbi will gain increasingly wide acceptance and that the internationalization process it embarked on will not be reversed. In particular, more than 70% clients surveyed by HSBC indicated that they believed that RMB transactions in their industry will grow in the next five years, with 27% predicting that it will grow by more than 20%.[113] In the case of Canada, BOC notes that RMB business volume through BOCC doubled each year since its inception, balancing out concerns that the volume of RMB transactions in Canada is lower than that of many other countries.[114] However, the Agricultural Bank of China identified capital controls and a weak financial market in China as potential obstacles to RMB internationalization. Banks will need to begin offering a greater number and diversity of offshore RMB products to create a network that will support the internationalization of the currency.[115] Additionally, there are financial commentators in China who warn that lifting capital controls can result in RMB losing its stability and relative lack of exchange risk, the qualities that made the redback an attractive international currency in the first place.[116]

By 2017-2020, China is expected to have lifted capital control. This could signal that offshore hubs will no longer be needed in the future to clear transactions and that their role will be replaced by the China International Payments System (CIPS), which was established in Shanghai in 2014.[117] Nevertheless, the global race for offshore RMB hubs will remain an active one as hubs play an instrumental role in helping the RMB's internationalization to take off, bringing the international financial system closer to having stability and alternative to the U.S. dollar. With government officials in France, Switzerland and other countries also starting to meet with representatives from China's central bank, it remains to be seen how Canada will engage in its upcoming talks, how it will proceed with first-steps such as a swap agreement and direct-trading, as well as how market actors will respond to the increasing significance and availability of the RMB settlement opportunities worldwide. In the long run, given Canada's financial expertise, Canada could begin to offer RMB investment tools such dim sum bonds and derivatives, this time listing the bonds on Canadian exchanges rather than in Luxembourg. It could also launch initial public offerings (IPOs) of Chinese companies. In addition, given data attesting to the rapid subscription of offshore bonds denominated in RMB and B.C.'s experience as an AAA-rated dim sum bond issuer, B.C. is in a good position to issue bonds in the future. It is conceivable that Vancouver could become a major centre for issuing and floating bonds should it become host to an RMB hub.

Concluding remarks

In the 1970s and 1980s, Canada's corporate head offices and financial services migrated *en masse* from Montréal to Toronto. This cemented the reversal of position that Canada's number one and number two cities had been undergoing since the end of World War II. While triggered in significant part by political upheavals in Quebec, Montréal's reversal of fortune was also linked to the fact that Canada's economic "centre of gravity" was shifting.[118] Namely, the city's significance to the Canadian economy, founded on its position as the major manufacturing and processing centre for Canada's Atlantic trade, had been eroded by the postwar economic decline of Europe and the corresponding rise of the United States. Additionally, Southern Ontario came to prominence in the later decades of the twentieth century for its proximity and well-connectedness to the nerve centre of the American automotive industry. To a smaller extent, the population growth and economic development of the Canadian West also played a part in engineering Toronto's rise.[119]

The global economic patterns that mobilized the "southwestward" shift of the Canadian economy in the twentieth century retain their relevance in today's global economic conditions. Due to the decline of manufacturing in the United States and the expansion of the Chinese economy, the world's geographies of production are once again in flux. Canada once more needs to turn its attentions westward and adopt corresponding strategies of growth. The government's decision to move forward with talks regarding the Canadian RMB hub signals that it is aware of the need. Beyond this, the candidacy of Vancouver as the Canadian hub provides an additional opportunity for Canada to assert its presence on the global economic stage and for Vancouver, in turn, to reposition itself in the Canadian economy.

The establishment of an offshore hub in Canada would enable around the clock trading of the RMB, which would in turn link other offshore centres together and accelerate its internationalization. However, creating a viable RMB hub in Canada will require sufficient redback liquidity and clearing capabilities. As such, the Bank of Canada should pursue a bilateral swap agreement with its Chinese counterpart, move toward direct trading between Canadian dollars and the redback, and a Chinese clearing bank should be selected. Once capital controls in China are relaxed, more Chinese investment and trade are likely to follow, which in turn will lead to the creation of high-income jobs in finance and other key sectors in Canada. Furthermore, investors will gain access to diversified sources of global liquidity for lending and borrowing as the RMB completes its internationalization.

The process is still far from complete. The development of an RMB hub in Canada will require the coordination of interests among actors in Canada and China, the promotion of trade invoiced in RMB, and the creation of policies and laws to supervise the initiative. There is still much uncertainty regarding implementation of each step of the process and the viability of a hub in Canada. Nevertheless, Canada is demonstrating prescience in preparing the country for the Pacific economy. The rise of an international currency is an infrequent phenomenon and given China's meteoric rise, its implications will be immense. It has historic significance and tremendous potential, for Canada and in particular Vancouver to capitalize upon.

Footnotes

[1] Legault & Dobson (2014, Apr. 7).

[2] Walsh & Weir (2014), p. 81.

[3] Wen (2014, May 5).

[4] Walsh & Weir (2014), p. 17.

[5] Ibid.

[6] Prasad & Ye (2012a), p. 29, Table 3-1.

[7] Walsh and Weir (2014), p. 100.

[8] Bank of China-Canada (2014, June), 9.

[9] Li (2013, Dec. 3).

[10] Walsh and Weir (2014), p. 16.

[11] Walsh and Weir (2014), p. 63.

[12] Walsh and Weir (2014), p. 17.

[13] Bowles P. & Wang, B. (2013), p. 1366.

[14] For further discussion on inertia effects, refer to Walsh and Weir (2014), p. 84, 97-98.

[15] HSBC (2013), 1.2.-1.3.

[16] HSBC 2014 Survey (as cited in Hampel, 2014, July 9; and CNW, 2014, July 9).

[17] Walsh and Weir (2014), p. 95-98.

[18] Ibid., p. 96.

[19] Industry Canada (2014).

[20] Edwardson, (2013, Nov. 4).

[21] Presentation by the Bank of China at the China-Canada Economy and Finance Forum, June 6, 2014.

[22] Embassy of PRC in Canada (2014, June 19).

[23] Statistic Canada (2011a; 2011c; 2011d).

[24] Asia Pacific Foundation (2014), p. 3-4, 17, 24-33,

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[53] For more information on shadow banking, refer to Economist (2014, May 10).

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[102] Beardsley et al. (2007), p. 2-3, 27-36.

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[104] Startup Genome (2012), 2.

[105] These business service sectors tend to be drawn toward the same locations because their activities support the same clientele, the head offices of producers in the global economy, and because their activities support one another. Locating in the same city allows business services to coordinate face-to-face meetings with producers and one another more reliably, establishing an environment of open communication and trust that is crucial for the effective management of complex global business activities. See Sassen (all publications), especially Sassen (2006), 60, 63-78, 122-125. In addition, business services tend to cluster together because workers in these knowledge intensive sectors tend to prefer similar amenities, including multiculturalism, sustainability and the presence of other "creative

professionals" such as themselves. The ability of business service sectors and "creative professionals" class to replenish itself is a reason why they are sometimes seen as the drivers of postindustrial urban development. See Florida (2012), Chapter 3.

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