# The Start of a New Age of Sino-Japanese Financial Cooperation as a Result of the December 2011 Sino-Japanese Summit

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## I. Closer financial cooperation between China and Japan

### 1. Financial achievements of Sino-Japanese summit

On 25 December 2011, Japan's prime minister, Yoshihiko Noda, visited China for the first time since coming to office and held a summit meeting with China's premier, Wen Jiabao. Although the focus of the meeting was on politics and foreign affairs, especially closer Sino-Japanese cooperation over the uncertain situation on the Korean Peninsula, the two leaders also discussed economic relations between the two countries. The main item of interest on this front was an agreement to improve cooperation on developing the two countries' financial markets.

### 2. Details of agreement on financial cooperation

According to the joint communiqué released after the summit by Japan's Ministry of Finance[1] and the People's Bank of China[2], the two leaders agreed that the two countries should cooperate more closely in the field of financial markets and foster financial transactions between them in order to form even closer economic and financial ties. The two leaders also agreed that the two countries should cooperate in the following specific areas, subject to the principle that any developments should be market-driven (Figure 1).

### 1) Encouraging the use of the yen and the renminbi for cross-border transactions between the two countries

The first main element of the agreement is measures to encourage the use of the yen and the renminbi for cross-border transactions between the two countries. The first of these is to encourage the use of the yen and the renminbi for settling trade

1 See http://www.mof.go.jp/international_policy/convention/dialogue/japan_china_financial_cooperation.htm.
2 See http://www.pbc.gov.cn/publish/goutongjiaoliu/524/2011/20111225191841656522157/20111225191841656522157_.html.

**Figure 1: Enhanced Cooperation for Financial Markets Development between Japan and China (Fact Sheet)**

| | |
|---|---|
| Preamble | To support the growing economic and financial ties between Japan and China, the leaders of Japan and China have agreed to enhance mutual cooperation in financial markets of both countries and encourage financial transactions between the two countries, specifically in the following areas, paying attention to the principle that these developments should be market-driven. |
| Items of agreement | I. Promoting the use of JPY and RMB in cross-border transactions between Japan and China.<br>・ Facilitating trade settlement in JPY and RMB to reduce foreign exchange risks and transaction costs for exporters/importers in both countries; and<br>・ RMB-denominated FDIs from Japan to Mainland China, including to subsidiaries of Japanese companies. |
| | II. Supporting the development of direct exchange markets between JPY and RMB; |
| | III. Supporting sound development of JPY and RMB bond markets. |
| | ・ ①RMB-denominated bonds issued by Japanese companies in Tokyo and other overseas markets;<br>②and RMB-denominated bonds issued by Japan Bank for International Cooperation in mainland China markets as a pilot program; and<br>・ Application process is underway for the Japanese authority to invest in Chinese government bonds. |
| | IV. Encouraging the private sector to develop JPY-denominated and RMB-denominated financial products and services in the overseas markets; and |
| | V. Establishing "Joint Working Group for Development of Japan-China Financial Markets" to promote mutual cooperation in the above-mentioned areas. |
| Other items | In addition, we agreed to accelerate the ASEAN+3 financial cooperation, including introducing the regional crisis prevention function and further strengthening the crisis resolution mechanism of CMIM. |

Source: Nomura Institute of Capital Markets Research, from Ministry of Finance and PBOC data

transactions, thereby reducing the exchange rate risk and transaction costs for importers and exporters from both countries. The second is to encourage the use of the renminbi for direct Japanese investment in mainland China in general and investment in the local subsidiaries of Japanese companies in particular.

## 2) Fostering the development of a market for exchanging yen and renminbi directly

The second main element of the agreement is measures to foster the development of a market for exchanging yen and renminbi directly.

## 3) Fostering the healthy development of markets for yen and renminbi bonds

The third main element of the agreement is measures to foster the healthy development of markets for yen and renminbi bonds. The first of these is to facilitate the issuance of renminbi bonds by Japanese companies on markets outside China, especially in Tokyo. It was also agreed to facilitate a pilot program for the issuance of renminbi bonds by the Japan Bank for International Cooperation (JBIC) on mainland Chinese markets. The second measure is for Japan's monetary authorities to apply to be allowed to invest in Chinese government bonds.

### 4) Encouraging the development of yen and renminbi financial products and services by the private sector in overseas markets

The fourth main element of the agreement is measures to encourage the development of yen and renminbi financial products and services by the private sector in overseas markets.

### 5) Establishing a joint working group to foster the development of financial markets in Japan and China

The fifth main element of the agreement is measures to establish a joint working group to foster the development of financial markets in Japan and China in order to encourage cooperation in the aforementioned areas.

The Chinese members of the working group will be the People's Bank of China and some other authorities, while the Japanese members will be the Ministry of Finance, the Bank of Japan, and the Financial Services Agency. The two sides also agreed to consider and discuss whether there were any rules or practices that they needed to deal with on behalf of the private sector.

# II. Significance of and issues raised by financial cooperation agreement

In our view, the financial cooperation agreement is not only an important step by the two governments towards fostering financial transactions between their private sectors: it also raises a number of issues.

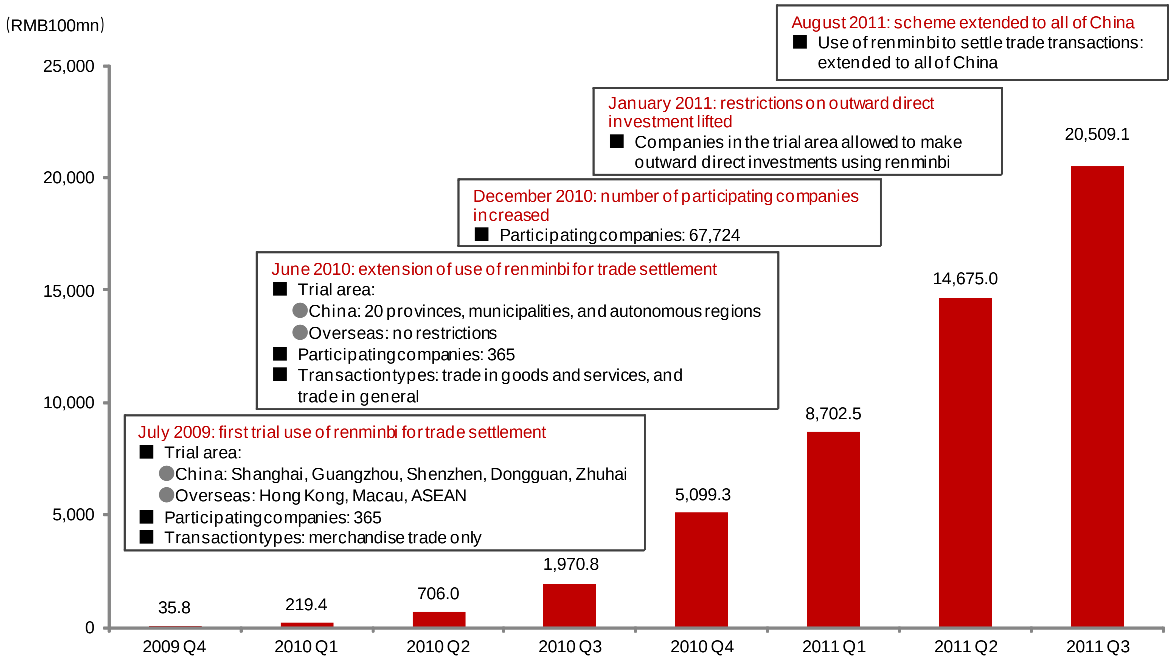
## 1. Making it easier for Japanese companies to trade and invest

### 1) Previous moves to expand the use of the renminbi in cross-border transactions

The agreement should make it easier for Japanese companies to use the renminbi in cross-border trade and investment transactions.

The Chinese authorities first allowed the renminbi to be used to settle trade transactions on a limited scale in July 2009 but then extended this to all China's trading partners in June 2010. Furthermore, trials on the mainland were extended to companies in all provinces and municipalities in August 2011 (Figure 2). Between July 2009 and the end of September 2011 a total of RMB2,050.9 billion was used to settle trade transactions. However, 90% of this total was transactions involving Hong Kong.

**Figure 2: Deregulation and (cumulative) amount of trade settled in renminbi**




Source: Nomura Institute of Capital Markets Research, from PBOC and other data

The first use of the renminbi to settle investment transactions was in a direct investment trial conducted in response to its increased use in trade transactions and in order to enable the money to find its way back to the mainland[3]. During the trial period, however, regional differences occurred in the way the rules were interpreted and implemented. As a result, a new set of rules was introduced by the Ministry of Commerce and the People's Bank of China on 14 October 2011 after Vice Premier Li Keqiang gave a speech on the subject in Hong Kong on 16 August of that year. As of 14 December 2011, the Ministry of Commerce had received 78 applications for such transactions, 74 of which it had approved, according to Huang Feng, Vice Chairman of the Department of Foreign Investment Administration[4]. These 74 direct investment projects were worth a total of RMB16,530 million, and 70% of them in value terms was initiated in Hong Kong.

Residents of Hong Kong have been allowed to open renminbi deposit accounts since 2004. Bank of China (Hong Kong) is the only bank allowed by the People's Bank of China to act as clearing agent for trade transactions settled in renminbi, thus establishing a clearly defined route from the mainland. This is what is referred to as Hong Kong's offshore renminbi market.

3 For more about renminbi-denominated inward direct investment and the issuance of renminbi bonds in Hong Kong, see Sekine, Eiichi, "Renminbi-denominated Inward Direct Investment Gets Underway in China," Nomura Journal of Capital Markets, Spring 2012, Vol.3, No.4.

4 Business China, 15 December 2011.

**Figure 3: Issuance of *dim sum* bonds**

| Year | Issuer | | Issue amount (RMB100mn) |
|---|---|---|---|
| | Residents | Non-residents | |
| 2007 | Policy banks (China Development Bank, Export-Import Bank of China)<br>State-owned commercial banks (Bank of China, etc.) | – | 100 |
| 2008 | Policy banks, state-owned commercial banks | – | 120 |
| 2009 | Chinese government (Ministry of Finance)<br>Policy banks, state-owned commercial banks<br>Foreign banks (HSBC, Bank of East Asia) | – | 160 |
| 2010 | Chinese government (Ministry of Finance)<br>Policy banks, state-owned commercial banks | Non-financial companies (Hopewell Holdings, McDonald's, etc.)<br>Financial companies (UBS, ANZ) | 357.6 |
| 2011 | Chinese government (Ministry of Finance)<br>Policy banks, state-owned commercial banks<br>Non-financial companies (Baosteel Group) | International financial organizations (World Bank, IFC, Asian Development Bank)<br>Government-backed financial institutions (Korea EximBank)<br>Non-financial companies (YFY, Volkswagen, etc.)<br>Financial institutions (ICBC Asia) | Approx. 1,000 |

Note: The issue amount for 2011 is the amount announced by HKMA on 17 January 2012.
Source: Nomura Institute of Capital Markets Research, based on data from the Securities and Futures Commission of Hong Kong and other sources

### 2) Establishing a route for an offshore renminbi market in Tokyo

If, as a result of the agreement, a route can also be established for an offshore renminbi market in Tokyo in addition to the market in Hong Kong, Japanese companies would probably be more willing to use renminbi.

If this is to happen, however, there needs to be a smooth flow of renminbi from Hong Kong to Tokyo. Another possibility might be for Bank of China's Tokyo branch to obtain a license from the Chinese authorities to act as clearing agent for the Tokyo market, thus enabling a greater flow of renminbi from the mainland. It also remains to be seen to what extent Japanese financial institutions could become involved in the supply of renminbi to an offshore market in Tokyo.

## 2. Establishing and expanding a route for raising and investing renminbi

### 1) Renminbi bond issuance by Japanese companies on the Hong Kong market

Since 2007, mainland Chinese issuers have been allowed to issue renminbi bonds in Hong Kong, while, since October 2009, China's Ministry of Finance has issued renminbi Chinese government bonds there (Figure 3). In addition, since a July 2010 agreement between mainland China and Hong Kong to increase the use of the renminbi for settling trade transactions, non-Chinese companies and financial institutions have also been allowed to issued renminbi bonds.

Called "Euroyuan bonds" by some, these bonds have tended to be affectionately called *dim sum* bonds ever since the US fast food group McDonald's issued such a bond in August 2010. Issuance of renminbi bonds in Hong Kong, including *dim sum* bonds, grew from RMB10.0 billion in 2007 to RMB12.0 billion in 2008 and

RMB16.0 billion in 2009. However, after the Chinese authorities allowed the renminbi to be used for settling trade transactions in 2009, issuance increased to RMB35.8 billion in 2010 and RMB86.8 billion as of 8 December 2011. In fact, issuance of *dim sum* bonds in 2011 appears to have reached RMB100 billion. A number of Japanese companies have begun to issue *dim sum* bonds, while a number of Japanese financial institutions have been involved in underwriting them.

### 2) Need for an offshore renminbi market in Tokyo to have adequate volume and liquidity

We would expect an increase in the issuance of renminbi bonds by Japanese companies to lead them to make more direct investments using the renminbi. In particular, we would expect the issuance of renminbi bonds on a Tokyo offshore market to make it easier for Japanese companies to use the renminbi. However, this raises the issue of how to find investors for any such bond issues. We can imagine situations where, depending on how active and liquid such a market was, it might be necessary to try to attract investors from Hong Kong.

If renminbi bonds were to be issued in Tokyo, the amount of renminbi available in Tokyo to purchase such bonds would need to increase. For this to happen, the first requirement would be to foster the use of the renminbi to settle trade transactions on a Tokyo offshore market. In particular, Japanese companies would have to be prepared to accept renminbi in payment for the goods and services they supply to Chinese companies. The second requirement would be for investors to be allowed to open renminbi bank accounts. The third would be to study the rules governing the issuance of renminbi bonds in Hong Kong as well as the associated disclosure requirements and to combine these with the need for a convenient issuing system and investor protection.

### 3) Need for greater diversity among issuers of renminbi bonds in mainland China

Renminbi bonds issued by non-residents of mainland China are known as panda bonds (in the same way as yen bonds issued by non-residents of Japan are known as samurai bonds)[5]. In February 2005 the People's Bank of China, the Ministry of Finance, the State Development and Reform Commission, and the China Securities Regulatory Commission (CSRC) jointly published *Provisional Administrative Rules on International Development Institutions' Issuance of RMB Bonds*, and in October of the same year the Asian Development Bank (ADB) and the International Finance Corporation (IFC) issued RMB1.0 billion and RMB1.13 billion, respectively, of renminbi bonds. Then, in November 2006, the IFC and the ADB issued RMB870

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[5] For more about the issuance of panda bonds, see Sekine, Eiichi, "Chuugoku ni Okeru Hikyojuusha Jinmingendate Saiken (Pandasai) Shijou no Genjou to Kadai" (China's Panda Bond Market), Capital Market Quarterly, Summer 2006 (Japanese only).

million and RMB1 billion, respectively of such bonds. However, no more such bonds have been issued since.

In May 2010 Bank of Tokyo–Mitsubishi UFJ issued RMB1.0 billion of renminbi bank debentures on the Chinese interbank bond market, while in October of the same year GMAC-SAIC Automotive Finance issued RMB1.5 billion of bank debentures on the same market. Both issuers were resident in China. Similarly, in December 2011 Mitsubishi Corporation (China) Co., Ltd., Mitsubishi Corporation's Chinese subsidiary, registered a program for issuing up to RMB500 million in commercial paper, also on the interbank bond market. However, there have been no more such issues by non-Chinese issuers since.

Therefore the issuance of panda bonds by JBIC, a Japanese government-backed financial institution, should help to diversify the range of issuers on China's bond market and encourage non-Chinese private-sector borrowers to issue bonds in mainland China, regardless of whether they are residents or non-residents. However, a number of technical issues will have to be resolved if non-residents are to issue renminbi bonds. This will require clarification of some of the details of the aforementioned *Provisional Administrative Rules*, including issue terms, the use of proceeds, disclosure requirements, and accounting standards.

## 3. Increase in the number of renminbi financial products

This growing use of the renminbi for trade, investment and bond issuance is likely to lead to a growing demand for and supply of renminbi financial products and services. In this process, the aforementioned joint working group is likely to play a key role in resolving any regulatory or practical constraints on the development of such products.

Among the areas on which it was agreed that China and Japan should cooperate, progress in developing a market for exchanging yen and renminbi directly is likely to depend on the pace and details of how China reforms its exchange rate system as the two are interlinked.

Also, on 19 August 2010, the People's Bank of China added the Malaysian ringgit to the major international currencies against which it has traditionally set an official mid-rate for the renminbi every day of the week: the US dollar, the euro, the yen, sterling, and the Hong Kong dollar. Then, on 22 November of the same year, it added the ruble and, on 28 November 2011, the Australian dollar and the Canadian dollar. Unlike the yen, whose exchange rate against the renminbi is set via the US dollar, the rates of the Australian dollar and the Canadian dollar are quoted directly against the renminbi. Therefore, before the yen is quoted directly against the renminbi, more research needs to be done into how the exchange rate mechanism works for currencies, such as these, that are already quoted directly against the renminbi.

## III. Background to Japanese government's request to be allowed to buy Chinese government bonds

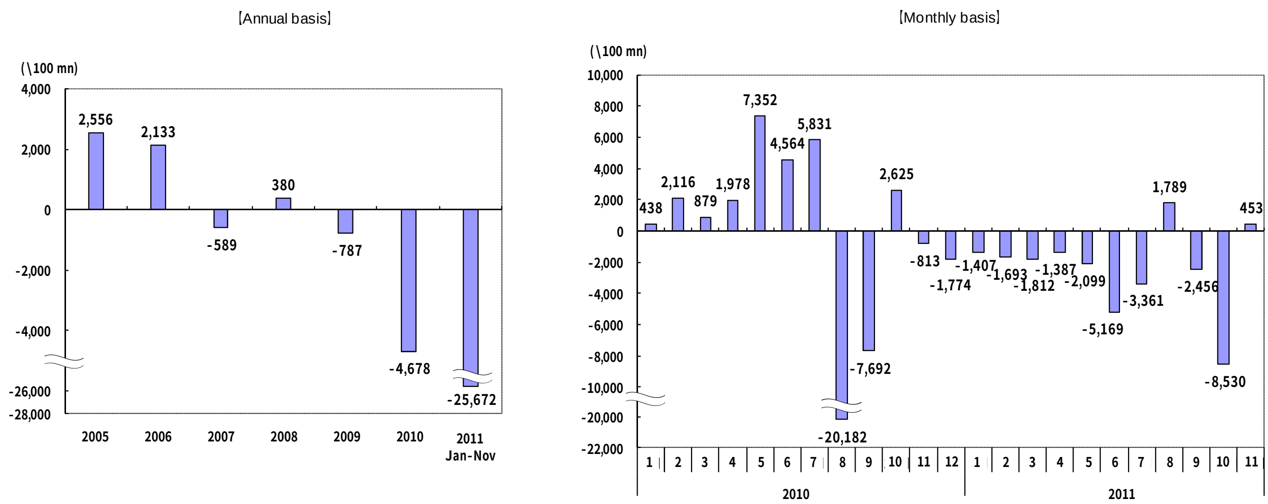
### 1. China's increasing purchases of Japanese (government) bonds

One of the measures that was agreed is that Japan's monetary authorities will be allowed to apply to invest in Chinese government bonds.

We need to see this in the light of the fact that, since 2010, China has been an increasingly active purchaser of Japanese (government) bonds. In the first seven months of that year China purchased a net ¥2,315.8 billion of Japanese bonds (Figure 4). Of this amount, ¥2,361.3 billion consisted of net purchases of short-term bonds with a maturity of less than 12 months, while ¥45.5 billion consisted of net sales of medium- and long-term bonds. We can therefore say that China was typically a net purchaser of short-term bonds during this period. However, in August 2010, China sold a net ¥2,018.2 billion of Japanese bonds, offsetting most of its net purchases during the preceding seven months.

China remained a net seller of Japanese bonds in general after September 2010 and sought to gain from the strength of the yen. However, it remained a net purchaser of medium- and long-term Japanese bonds from October 2010 to May 2011. In particular, it purchased a net ¥165.2 billion in February 2011, a net ¥234.5 billion the following month, and a net ¥1,330.0 billion the month after that. According to the latest figures, China sold a net ¥2,567.2 billion of Japanese bonds in general between January and November 2011. While it sold a net ¥3,120.2 billion of short-term bonds, it purchased a net ¥553.0 billion of medium- and long-term bonds.

**Figure 4: Chinese purchases of Japanese (government) bonds**




Source: Nomura Institute of Capital Markets Research, from Ministry of Finance data

## 2. Significance of China's diversification of the way it manages its foreign exchange reserves

After overtaking Japan as the world's largest holder of foreign exchange reserves in February 2006, China saw its foreign exchange reserves break the $3 trillion barrier in March 2011 and grow to $3,181.1 billion as of end-December 2011.

Some 70% of these reserves is reported to be denominated in US dollars, with most of this amount managed by the State Administration of Foreign Exchange (SAFE), an arm of the People's Bank of China, in the form of US Treasury securities. The choice of US Treasuries can be attributed to China's need to make trade payments in US dollars and to the liquidity of the US Treasury market. In September 2007, China Investment Corporation (CIC) was established with an initial capital of $200 billion from China's foreign exchange reserves and assigned the task of reducing the downside risk and improving the return on the reserves it manages.

On 1 December 2009 SAFE published its *Overview of Foreign Exchange Administration*. This was followed, in July 2010, by its publication of *FAQs on Foreign Exchange Management Policies*. In both documents SAFE makes it clear that its management of China's foreign exchange reserves is governed by three criteria: risk, liquidity, and return. The documents also reveal that SAFE invests in assets such as government bonds, agency bonds, supranational bonds, corporate bonds, and investment funds, while it invests not only in major international currencies such as the US dollar, the euro, and the yen but is seeking to diversify into emerging market currencies as part of its policy of international diversification. The aforementioned purchases and sales of Japanese bonds can be considered part of these diversification efforts.

## 3. China's expanding government bond market

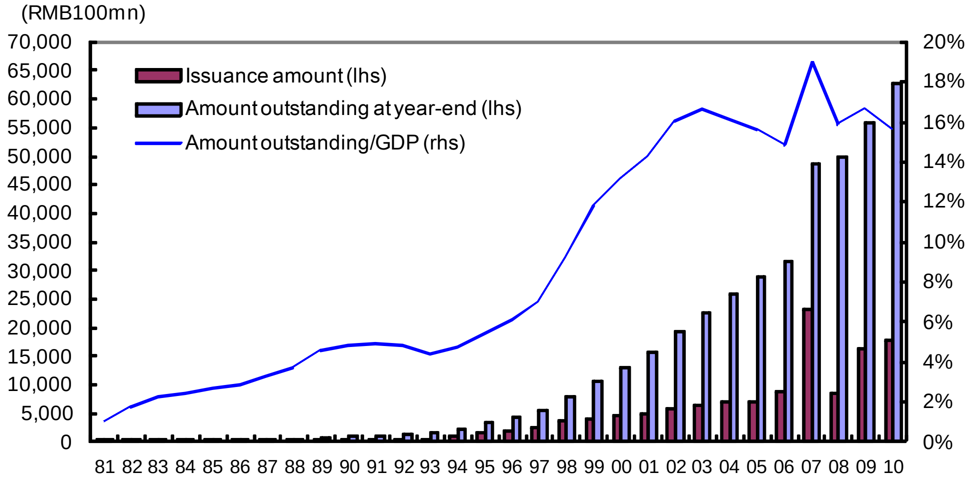
### 1) Mainland Chinese government bond market

Mainland China resumed issuance of government bonds in 1981, a few years after the market-oriented reforms of 1978. Therefore 2011 marks the 30th anniversary of this resumption. There are three different types of Chinese government bonds: book-entry bonds, certificated bonds, and savings bonds. In addition, there are two primary markets for government bonds: the interbank bond market, which is regulated by the People's Bank of China, and the exchange market, which is regulated by the CSRC. However, the main primary and secondary market is the interbank bond market.

China issued RMB1,777.8 billion (roughly ¥22 trillion)[6] of government bonds in 2010 (Figure 5). In addition, there was RMB6,262.8 billion (roughly ¥77 trillion) of government bonds outstanding as of the end of 2010. This seems worlds apart from 1981, when only RMB4.9 billion was issued.

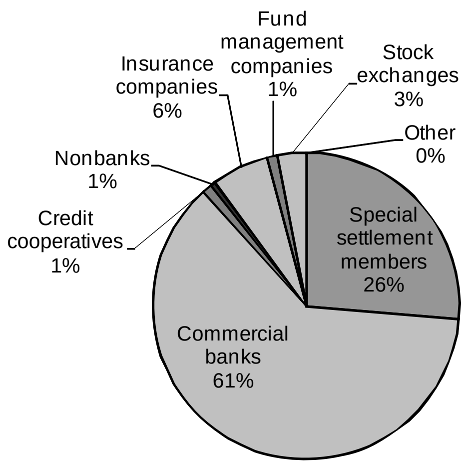
6 We have converted amounts in renminbi as of end-2010 to yen using the mid-rate on 31 December 2010 (RMB1 = ¥12.3).

**Figure 5: Issuance and outstanding amount of Chinese government bonds**




Source: Nomura Institute of Capital Markets Research, from Shanghai Wind Information Co., Ltd., China Securities and Futures Statistical Yearbook, National Bureau of Statistics, China Government Securities Depository Trust & Clearing Co. Ltd, and chinabond.com data

**Figure 6: Ownership of book-entry government bonds on mainland Chinese market (end-2010)**




Note: 1. Ownership figures are for the interbank bond market.
2. The outstanding amount of book-entry government bonds as of the end of 2010 was RMB5,962.8 billion.

Source: Nomura Institute of Capital Markets Research, from chinabond.com data

## 2) Mainland Chinese government bonds aimed at domestic investors

Almost all the investors in mainland Chinese government bonds are Chinese residents. For example, as of the end of 2010, 61% of the RMB5,962.8 billion of book-entry government bonds outstanding on the interbank bond market was held by commercial banks, 26% by special settlement members (e.g., the People's Bank of China, the Ministry of Finance, the policy banks, and China Government Securities Depository Trust & Clearing Co., Ltd), and 6% by insurance companies, with roughly 90% held by commercial banks and the government sector (Figure 6).

**Figure 7: Main terms of third issue of renminbi government bonds in Hong Kong**

| Terms | Details |
|---|---|
| Issue date | 17 August 2011 |
| Issue amount | RMB20 billion (RMB15 billion for institutional investors, RMB5 billion for retail investors) |
| 2-year bonds | RMB5 billion (retail investors), coupon: 1.6% |
| 3-year bonds | RMB6 billion (institutional investors), coupon: 0.6% |
| 5-year bonds | RMB5 billion (institutional investors), coupon: 1.4% |
| 7-year bonds | RMB3 billion (institutional investors), coupon: 1.94% |
| 10-year bonds | RMB1 billion (institutional investors), coupon: 2.36% |
| Methods of tender and sale | Government bonds for institutional investors are offered for tender and issued by Hong Kong's Central Moneymarkets Unit, and the Hong Kong branch of Bank of Communications Acts as issue agent<br>The lead managers for government bonds for retail investors are Bank of China (Hong Kong) and HSBC |
| Retail sales agents | 19 banks |
| (Mainland China) | Bank of China (Hong Kong), Bank of Communications (Hong Kong), China Construction Bank (Asia), Industrial and Commercial Bank of China (Asia), CITIC Bank International, Shanghai Commercial Bank |
| (Hong Kong) | HSBC, Bank of East Asia, Chiyu Banking Corporation, Chong Hing Bank, Dah Sing Bank, Hang Seng Bank, Nanyang Commercial Bank, , Wing Hang Bank, Wing Lung Bank |
| (US, Europe, rest of Asia) | Citibank (Hong Kong), DBS Hong Kong, Fortis Bank (Hong Kong), Standard Chartered Bank (Hong Kong) |

Source: Nomura Institute of Capital Markets Research, from Chinese Ministry of Finance data

The amount held by (resident) foreign banks, also as of the end of 2010, was only RMB55.2 billion (roughly 0.9% of the book-entry government bonds outstanding on the interbank bond market). In terms of increasing the market's liquidity, turnover and depth, institutional investors play a key role on the bond market, and the advent of foreign institutional investors will probably help the market to develop.

### 3) Hong Kong's renminbi government bond market

Since 2004, it has been possible to open a renminbi deposit account in Hong Kong; and, since 2007, mainland Chinese companies have been allowed to issue renminbi bonds there. In October 2009 China's Ministry of Finance issued its first renminbi bond in Hong Kong. In addition, since a July 2010 agreement between mainland China and Hong Kong to increase the use of the renminbi for settling trade transactions, non-Chinese companies and financial institutions have also been allowed to issued renminbi bonds there.

Issuance of renminbi government bonds in Hong Kong has increased in the three years since October 2009 from RMB6.0 billion to RMB8.0 billion in November 2011 and RMB20.0 billion in August 2011. Renminbi government bonds are one of the main instruments traded on Hong Kong's offshore market, and the Chinese government is committed to continuing to issue bonds there.

Although there are no official statistics on the ownership of renminbi government bonds issued in Hong Kong, the lion's share is taken up by banks from mainland China and Hong Kong (Figure 7), and investors can buy them on the OTC market.

Although the amount of renminbi bonds that individual investors can buy OTC is limited to the amount they are allowed to convert into renminbi (RMB20,000/day), foreign investors can also buy them.

# IV. Schemes for purchasing Chinese government bonds

## 1. Example of closer financial cooperation between China and Japan

We expect that the agreement and the Japanese government's resulting purchases of Chinese government bonds will contribute to the development of the Chinese bond market by encouraging other institutional investors, from both Japan and elsewhere, to participate in the market. Moreover, the participation of foreign investors should extend the range of options available to Japanese investors if renminbi securities can be traded internationally.

## 2. Scheme for qualified foreign institutional investors

There are two schemes that enable foreign investors to buy Chinese government bonds on mainland China's bond markets.

The first is the Qualified Foreign Institutional Investor (QFII) scheme, established in 2002. Under this scheme, overseas institutions (such as fund management companies, insurance companies, securities companies, commercial banks, and pension funds) that have been licensed by the CSRC are allowed to invest in Chinese securities (such as listed equities, listed bonds, and shares in mutual funds) up to a limit (amount) set by the State Administration of Foreign Exchange (SAFE). As of end-November 2011, 121 foreign institutions had been licensed by the CSRC, and the total limit (covering 108 institutions) set by SAFE, also as of end-November 2011, was $21.14 billion.

In practice, however, the scheme has not given foreign investors (mainly fund management and securities companies) access to the government bonds issued and traded on the interbank bond market, whose primary and secondary markets are both much larger than the exchange market. This is because the scheme only allows them to buy and sell securities listed on the exchange market.

However, under the scheme, investors place orders with mainland Chinese securities companies and open custody accounts with mainland Chinese custodians. As of end-November 2011, the 12 Japanese institutions licensed under the scheme accounted for $2.1 billion (or 9.93%) of the total QFII investment limit (Figure 8). A number of foreign central banks, including those of Norway ($700 million), Malaysia ($200 million), Hong Kong ($300 million), and Singapore (n/a), have also been licensed under the scheme (Figure 8). We assume that, once the agreement is signed, the Japanese government will be able to benefit from the investment experience and expertise of Japanese financial institutions and foreign central banks on mainland China's markets.

## Figure 8: Criteria for recognition as qualified foreign institutional investor (QFII) (Japanese financial institutions and foreign government-sector institutions)

| Institution | Date of qualification | Investment limit |
|---|---|---|
| **Japanese institutional investors** | | |
| Nomura Securities | 23 May 2003 | $50 million (4 June 2003)<br>⇒$350 million (increased on 7 November 2006) |
| Nikko Asset Management | 11 December 2003 | $50 million (9 February 2004)<br>⇒$250 million (increased on 15 September 2004)<br>⇒$450 million (increased on 17 May 2006) |
| Daiwa SMBC (Daiwa Securities Capital Markets) | 10 May 2004 | $50 million (5 July 2004) |
| Dai-ichi Life Insurance | 28 December 2005 | $100 million (22 February 2006)<br>⇒$200 million (increased on 28 July 2008) |
| Shinko Securities (Mizuho Securities) | 5 September 2006 | $50 million (13 February 2007) |
| Sumitomo Mitsui Asset Management | 25 September 2006 | $200 million (13 February 2007)<br>⇒$300 million (increased on 19 June 2008)<br>⇒$350 million (increased on 28 July 2010) |
| Daiwa Asset Management | 11 September 2008 | $100 million (26 December 2008)<br>⇒$200 million (increased on 26 November 2010) |
| Mitsubishi UFJ Morgan Stanley Securities | 29 December 2008 | $100 million (25 March 2009) |
| Sumitomo Trust & Banking | 26 June 2009 | $50 million (31 December 2009) |
| Nomura Asset Management | 23 November 2009 | $200 million (4 May 2010) |
| DIAM | 20 April 2010 | $200 million (1 September 2010) |
| Shinko Asset Management | 25 November 2011 | (tbc) |
| Total | | $2.1 billion |
| **Foreign central banks** | | |
| Institution | Date of qualification | Investment limit |
| Norges Bank | 24 October 2006 | $200 million (24 January 2008)<br>⇒$500 million (increased on 5 December 2008)<br>⇒$700 million (increased on 1 September 2010) |
| Bank Negara Malaysia | 19 May 2009 | $200 million (4 September 2009) |
| Hong Kong Monetary Authority | 27 October 2010 | $300 million (18 March 2011) |
| Monetary Authority of Singapore | 8 October 2011 | (tbc) |
| Bank of Thailand | 16 December 2011 | (tbc) |
| Bank of Korea | 21 December 2011 | (tbc) |
| Total | | $1.2 billion |
| **Sovereign wealth funds, government-backed banks** | | |
| Institution | Date of qualification | Investment limit |
| GIC | 25 October 2005 | $100 million (16 November 2005)<br>⇒$300 million (increased on 19 December 2008) |
| Temasek | 14 November 2005 | $100 million (12 December 2005)<br>⇒$300 million (increased on 16 September 2009) |
| Abu Dhabi Investment Authority | 3 December 2008 | $200 million (17 January 2009) |
| Korea Development Bank | 23 April 2009 | $100 million (9 November 2009) |
| CPPIB | 9 December 2011 | (tbc) |
| Kuwait Investment Authority | 21 December 2011 | (tbc) |
| KIC | 28 December 2011 | (tbc) |
| National Pension Service of Korea | 5 January 2012 | (tbc) |
| Total | | $900 million |

Note: 1. "Date of qualification" is the date of recognition as QFII by CSRC.
2. The date attached to the investment limit is the date on which SAFE approved an institution's investment quota.

Source: Nomura Institute of Capital Markets Research, from CSRC and SAFE data

## 3. Interbank bond market scheme

The second scheme that enables foreign investors to buy Chinese government bonds is the interbank bond market scheme. On 17 August 2010 the People's Bank of China permitted (1) overseas central banks, (2) renminbi clearing banks in Hong Kong and Macau (Bank of China), and (3) overseas banks authorized to settle trade transactions in renminbi to participate in China's interbank bond market. In return, banks wishing to participate in the market were required to obtain a license and an investment quota from the People's Bank of China.

Of the banks eligible in category (1), the Hong Kong Monetary Authority (HKMA) obtained a license in December 2010. As it obtained a QFII license to invest in (renminbi-denominated) A shares in October 2010, its acquisition of a second license meant that it was now licensed to invest in both mainland bonds and equities. More recently, on 10 November 2011, the Reserve Bank of Australia obtained a license to invest in Chinese government bonds. Similarly, of the banks in category (3), Industrial and Commercial Bank of China (Asia) and the Hong Kong branches of other mainland Chinese and overseas banks have also obtained licenses.

Other possibilities of translating the agreement into practice include negotiated transactions, which would be independent of these existing schemes. In any case, whatever scheme the Japanese government used to purchase Chinese government bonds, it would be likely to mark a development in the opening up of the mainland Chinese bond markets to overseas investors.

## 4. Impact on the internationalization of the renminbi

Although the People's Bank of China has yet to express an opinion about the purchase of Chinese government bonds by the Japanese government, one of the Bank's publications, *Financial News*, published the following assessments by three mainland Chinese experts on 24 December 2011 following a press conference by Japan's finance minister, Jun Azumi, on 20 December of that year.

First, Lu Zhengwei, chief economist of Industrial Bank, said that the Japanese government's decision to purchase Chinese government bonds marked an important step in the internationalization of the renminbi as it would be the first time that a G7 country had added renminbi to its reserves. He also said that he hoped the move would help to broaden the range of investors in mainland China's bond markets, lead to the issue of more longer-term bonds, and improve their yield.

Second, Guo Tianyong, Director of the Research Center of the Chinese Banking Industry, Central University of Finance and Economics, Beijing, said that China and Japan both faced the problem of how to diversify their foreign exchange reserves and that purchases of each other's government bonds would be in their mutual interest.

Third, Liu Junhong, Director of the Globalization Research Center and Professor of the Institute of Japanese Studies, China Institute of Contemporary International

**Figure 9: List of renminbi swap counterparties**

| Country/area | Counterparty (central bank) | Agreement date | Size (RMB100mn) | Duration | Amount in counterparty currency | Objective |
|---|---|---|---|---|---|---|
| Korea | Bank of Korea (before renewal) | 12 December 2008 | 1,800 | 3 years | KRW38trn | ・Short-term liquidity boost<br>・Trade settlement<br>・Addition to Chiang Mai Initiative<br>・Possible use of each other's currency as reserve currency |
| | Bank of Korea (after renewal) | 26 October 2011 | 3,600 | 3 years | KRW64trn | ・Closer financial cooperation<br>・Encouragement of trade and investment<br>・Regional financial stability<br>・Possible use of each other's currency as key reserve currency and possible percentage |
| Hong Kong | Hong Kong Monetary Authority (before renewal) | 20 January 2009 | 2,000 | 3 years | HK$227bn | ・Short-term liquidity boost<br>・Trade settlement |
| | Hong Kong Monetary Authority (after renewal) | 22 November 2011 | 4,000 | 3 years | HK$490bn | ・Financial stability in mainland China, Hong Kong, and rest of Asia<br>・Facilitation of trade and investment in mainland China and Hong Kong<br>・Development assistance to Hong Kong's offshore renminbi market |
| Malaysia | Bank Negara Malaysia | 8 February 2009 | 800 | 3 years | MYR40bn | ・Trade and investment settlement |
| Belarus | National Bank of Belarus | 11 March 2009 | 200 | 3 years | BYR8trn | ・Trade and investment settlement |
| Indonesia | Bank Indonesia | 23 March 2009 | 1,000 | 3 years | IDR175trn | ・Short-term liquidity boost, trade settlement, investment settlement |
| Argentina | Central Bank of Argentina | 2 April 2009 | 700 | 3 years | ARS38bn | ・Nothing in particular |
| Iceland | Central Bank of Iceland | 9 June 2010 | 35 | 3 years | n.a. | ・Trade and investment settlement |
| Singapore | Monetary Authority of Singapore | 23 July 2010 | 1,500 | 3 years | S$30bn | ・Trade and investment settlement |
| New Zealand | Reserve Bank of New Zealand | 18 April 2011 | 250 | 3 years | NZD4.9bn | ・Trade and investment settlement |
| Uzbekistan | Central Bank of Uzbekistan | 19 April 2011 | 7 | 3 years | UZS180.7bn | ・Trade and investment settlement |
| Mongolia | Bank of Mongolia | 6 May 2011 | 50 | 3 years | MNT943.4bn | ・Trade and investment settlement |
| Kazakhstan | National Bank of Kazakhstan | 13 June 2011 | 70 | 3 years | KZT157.4bn | ・Trade and investment settlement |
| Thailand | Bank of Thailand | 22 December 2011 | 700 | 3 years | THB320bn | ・Closer financial cooperation, encouragement of trade and investment, and regional financial stability |
| Pakistan | State Bank of Pakistan | 23 December 2011 | 100 | 3 years | PKR140bn | ・Closer financial cooperation, encouragement of trade and investment, and regional financial stability |
| UAE | Central Bank of the United Arab Emirates | 17 January 2012 | 350 | 3 years | AED20bn | ・Closer financial cooperation, encouragement of trade and investment, and regional financial stability |
| Total | | | 13,362 | | | |

Source: Nomura Institute of Capital Markets Research, from PBOC data

Relations, said that the Japanese government's decision was a positive development in the internationalization of the renminbi.

All three welcomed the decision as enhancing the renminbi's status and ending a situation where most of the countries with which the People's Bank of China has concluded swap agreements (Figure 9) and most of those holding renminbi in their reserves have been emerging economies.

## V. Japanese government adopting a more positive attitude to financial cooperation with China

### 1. International competition to be an offshore renminbi market

One factor behind the agreement is probably international competition to become an offshore market for a currency that is increasingly being used internationally. Japan

(Tokyo) is not the only country (city) to have made moves towards becoming an offshore renminbi market.

### 1) London

The first such case is London. At the Fourth UK-China Economic and Financial Dialogue on 8 September 2011, the UK Chancellor of the Exchequer, George Osborne, and Chinese Vice Premier Wang Qishan discussed the possibility of the renminbi being traded in the City. At the end of October 2011 Bank of Tokyo–Mitsubishi UFJ London became the first European branch of a Japanese bank to trade the renminbi[7].

### 2) Singapore

The second such case is Singapore. On 11 March 2011 the Singapore branch of Industrial and Commercial Bank of China, one of China's four main state-owned commercial banks, opened the bank's first overseas renminbi processing center. The center offers the following renminbi services: deposits, settlement, credit cards, internet banking, and cash transactions. The branch first accepted renminbi deposits in 2002 and, as of end-February 2011, had RMB 2.0 billion in renminbi deposits and had settled RMB12.4 billion in trade transactions.

The next development was on 9 September 2011, when Tommy Xie Dongming, an economist at OCBC Bank in Singapore, proposed establishing an offshore renminbi market in Singapore following a similar proposal by the UK government at the Fourth UK-China Economic and Financial Dialogue in London (see above)[8].

### 3) Taiwan

The third such case is Taiwan. In May 2011 the Financial Supervisory Commission of Taiwan's Executive Yuan announced that it would allow the overseas banking units (OBUs) and the foreign commercial representations of Taiwanese banks to engage in RMB business. On 15 September 2011 HSBC became the first foreign bank to be granted a license to offer RMB products and services in Taiwan and began offering RMB-related services through its offshore banking units on 19 September of that year. As far as Japanese banks are concerned, Mizuho Corporate Bank's Taipei branch was granted a license on 26 September 2011 and began offering RMB-related services on 29 September of that year.

At about the same time, on 14 August 2011, Taiwan's central bank listed being an offshore renminbi center as one of its long-term policy goals.

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7 See Nihon Keizai Shimbun, 30 October 2011.
8 See ftchinese.com, 9 September 2011.

**4) Tokyo**

In 2011 a number of online brokers in Tokyo (Rakuten Securities, SBI Securities, and Monex) began to offer their customers renminbi bonds[9]. Similarly, on 11 October 2011, Jibun Bank began to offer its retail customers renminbi deposits. Japanese retail investors therefore already have access to renminbi financial products. Moreover, in November 2011, Sumitomo Mitsui Banking Corporation signed a memorandum of understanding on renminbi banking services, including offshore trading, with Bank of China[10].

The difference between Tokyo and other cities and countries seeking to establish offshore renminbi centers (i.e., those other than Hong Kong) is that, in the case of Tokyo, there is an official working group set up by both the Chinese and Japanese governments to deal with the use of the renminbi. On 16 January 2012 HKMA and the UK Treasury announced the launch of a joint private-sector forum to enhance cooperation between Hong Kong and London on the development of an offshore renminbi market. However, the agreement between China and Japan is the first such agreement among G7 members.

## 2. Japanese government adopting a more positive attitude to financial cooperation with China

In our opinion, the agreement marks a new stage in financial cooperation between China and Japan.

First, it marks a major change in the Japanese government's attitude to financial cooperation with China as a result of China's emergence as an economic power. In the past, financial cooperation between the Japanese and Chinese governments took the form of a considered response by the Japanese government to a request by the Chinese government. Examples of this are the Japanese government's four yen loans to China (the first soon after the market-oriented reforms of 1978) and a series of loans by the former Export-Import Bank of Japan (now Japan Bank for International Cooperation). In contrast, the current agreement (as exemplified by the Japanese government's request to be allowed to buy Chinese government bonds) represents a more positive approach by the Japanese government where it has taken the initiative.

Second, the agreement marks the Japanese government's approval, indeed encouragement, of the use of the renminbi as well as the yen by Japanese companies and financial institutions for trade, investment, foreign exchange and bond dealing. In fact, we welcome the Japanese government's efforts to take advantage of the internationalization of the renminbi and establish an offshore renminbi market in Tokyo as a move to revitalize Tokyo as a financial center. Since the agreement, in

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9 See Nihon Keizai Shimbun, 9 November 2011.
10 See Nihon Keizai Shimbun, 24 November 2011.

January 2012, Japanese banks have been quick to make domestic loans[11] and offer letters of credit[12] in renminbi.

Third, the agreement extends to capital markets. As it is based on the principle that any developments should be market-driven, we would not be surprised if it led to the establishment of new financial markets, including bond markets, depending on the initiative of the private sector.

While we will have to wait for history to judge the agreement, it is probably fair to say at this stage that it is, at the very least, an attempt to redefine Japan's role in Asian finance. As far as the details of the agreement are concerned, much will presumably depend on the enthusiasm and ability of financial market participants to put it into practice. We expect the agreement to attract the attention of other members of the G7 and other countries in Asia, and it will be interesting to see whether it will indeed be the historical turning point that it promises to be.

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11 By Mizuho Corporate Bank. See press release of 6 January 2012 and Nihon Keizai Shimbun, 7 January 2012.

12 By Bank of Tokyo–Mitsubishi UFJ.