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CHINESE RENMINBI IN THE CARIBBEAN: OPPORTUNITIES FOR TRADE, AID AND INVESTMENT

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Chinese Renminbi in the Caribbean: Opportunities for Trade, Aid and Investment

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Abstract

Over the last two decades, the role of the People's Republic of China in global trade and in global investment has been ever expanding, resulting in an increasing engagement with the Caribbean. The accelerating internationalisation of the Chinese Renminbi (RMB) is a logical consequence of this Chinese quest for global geo-political influence. We analyse the potential benefits and risks of the use of RMB in the Caribbean, by also drawing on insights from existing examples of its use in commercial trade between China and Suriname. We also address the issue of de-risking and potential access to global financial services via the provision of Chinese corresponding banking relationships and access to Chinese payment systems. Eventually, the paper discusses the findings so as to provide policy recommendations regarding the use of RMB for the Caribbean.

Keywords: reserve currency, payment systems, international trade, foreign aid, foreign direct investment, financial institutions and services, China, Caribbean, RMB internationalisation

JEL codes: E42, F33, F21, F35, O16, G2

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SECTION 1

1. INTRODUCTION

1.1. This research paper aims at analysing the potential benefits and risks of the use of the Chinese Renminbi (RMB) in the Caribbean Development Bank's (CDB) Borrowing Member Countries (BMCs). To this end, the paper will draw on insights from existing examples of the use of RMB in commercial trade between the People's Republic of China and Suriname, a BMC that leads the Caribbean in RMB use. It will analyse which potentialities could arise in the use of RMB such as, increased trade and foreign direct investment (FDI), as well as currency and liquidity risks that would require mitigating actions. The paper also addresses the issue of the financial intermediation of aid, trade and investment funds *vis-a-vis* the provision of alternative financial networks in the form of Chinese corresponding banking relations and clearing houses. We analyse how these developments have presented opportunities to increase BMC access to global financial services. RMB's inclusion in the International Monetary Fund's (IMF) Special Drawing Rights (SDR) basket of reserve currencies has occurred under the broader theme of increased internationalisation of RMB. China has an expanding role in global trade, has internationalised the usage of RMB partly through the liberalisation of current account transactions and has provided many investment opportunities to BMCs. In this context, the paper aims at discussing the broader economic implications of this, including both new opportunities and risks in commercial and financial relations between China and BMCs. The paper also aims at providing an overview of the current landscape of Chinese presence in the Caribbean and the wider global economy. Eventually, the paper discusses the findings so as to provide policy recommendations for BMCs.

1.2. China's influence in the Caribbean region has increased considerably. The triple flows of aid, trade, and investment have all expanded at a catalytic rate. China's influence in the Caribbean has grown at a time that the United States of America (USA) and Europe have a reduced appetite for trade and investment in the Region, as well as for granting aid. China's diplomatic engagements with the Caribbean and the Americas has widened and deepened as China has explicitly incorporated expanding and enhancing diplomatic relations, trade, and investment with the Region into its foreign policy. This has been using state visits, exchanges, and various forms of development assistance as a policy instrument. In addition to this, the Caribbean faces unique challenges with respect to financial intermediation due to the withdrawal of correspondent banking services by North American and European financial institutions as they go through a de-risking process in response to changes in their financial laws and regulations. As Chinese aid and investment flows to the Caribbean increase and more Caribbean firms trade with China, some natural questions emerge which motivate our research. How would the use of RMB actually facilitate trade, aid and investment flows to the Caribbean region? Might the use of RMB provide an alternative to the US dollar as a transaction currency or as a reserve currency? Does this at all address the issue of de-risking in the Caribbean? Would use of RMB facilitate the arrival of new tourists from China and other parts of Asia? Even if the answer to all these questions is affirmative, what are the implications for risk, especially given that little is known about the financial regulation and supervision of Chinese banks? Might there be political ramifications? How would a system that incorporates RMB in the Caribbean work and how would we go about implementing it? Many of these questions would go beyond the scope and purpose of this paper, which rather sets out the main parameters for a fruitful discussion of the topic. The paper is intended to be neutral with respect to political interests and considers only economic and financial implications (even if induced by some political actions).

1.3. This paper is organised as follows: Section 2 provides a description of how China's political and economic engagement with the Caribbean region has evolved over the last two decades; Section 3 looks at practical applications and implications of RMB use; Section 4 discusses opportunities and risks associated with RMB use; and Section 5 summarises salient points discussed in the paper and conclusions.

SECTION 2

2. BACKGROUND

Political relations

2.1 The economic and diplomatic presence of China in the Caribbean has increased considerably, particularly in the last decade (Bernal, 2015). China's engagement with the Caribbean has largely taken place within a geopolitical context. The implication of the One-China Policy has been that countries seeking diplomatic relations with the People's Republic of China have had to break their official relations with Taiwan and vice-versa. This rivalry between mainland China and Taiwan has been manifested in the Caribbean region with a few countries oscillating between the two. Of the 21 countries that officially recognise Taiwan, six of them are in the Caribbean. Associated with these engagements are enticements in the form of development assistance and investment. Table 1 shows the diplomatic landscape in the Latin America and Caribbean region as it relates to China and Taiwan.

2.2 In 2008 China introduced a new policy on its engagement with Latin America and the Caribbean in an official White Paper to "*further clarify the goals of China's policy in this region, outline the guiding principles for future cooperation between the two sides in various fields and sustain the sound, steady and all-round growth of China's relations with Latin America and the Caribbean"*. Among the key goals in this policy were increased trade and investment, particularly in natural resources and infrastructure (Kotschwar, 2014)

2.3 In 2013 China's President Xi Jingping visited Trinidad and Tobago to meet with leaders of the Caribbean Community (CARICOM) with whom China has diplomatic relations. The purpose of this trip was to celebrate and solidify the growing friendship and ties between China and the Caribbean.

Chinese Foreign Direct Investment

2.4 Data shows that Chinese outbound foreign direct investment (OFDI) to the Caribbean has increased significantly over the last two decades, following China's explicit policy of encouraging increased overseas presence of Chinese firms and developing strong multilateral institutions. In 1979, state-owned entities (SOEs) were allowed for the first time to invest abroad, which commenced a gradual relaxation of regulations pertaining to OFDI from China for both state-owned and non-state owned firms. China is now the third largest foreign direct investor in the world according to the Organisation for Economic Co-operation and Development (OECD) [2014], following the USA and Japan which are the first and second largest global investors, respectively (Garcia-Herrero *et al* [2015]). The Government's explicit "Go Global Strategy" is an outward looking policy that has been enhanced by key administrative changes aimed at easing the doing business of investing abroad. For example, in 2011 the threshold for OFDI requiring Government approval was increased from thirty million (mn) United States dollars [USD 30 mn] to USD300 mn for resource investments and from USD10 mn to USD100 mn for non-resource projects.

2.5 So far, the initiative has been largely driven by centrally controlled SOEs, which in 2009 controlled roughly 68% of total Chinese outward direct investment (2009 Statistical Bulletin of China's Outward Foreign Direct Investment). Also, private firms operate in a complex system where economic decision making is dominated by the state and firms are inclined to be in line with the state's overall economic strategy. Hence, OFDI flows from SOEs or private firms essentially necessitate some extent of state-to-state diplomatic relations. Broadly speaking however, the thrust of OFDI has been consistently driven by the same factors, such as raw material seeking, efficiency seeking, market seeking, asset seeking and debt recovery. Particularly for the Caribbean, Chinese OFDI has mainly been constituted by development aid, infrastructure projects.

TABLE 1: DIPLOMATIC RECOGNITION OF CHINA AND TAIWAN

Region	China	Taiwan
South America	Argentina	Paraguay
	Bolivia	
	Brazil	
	Chile	
	Colombia	
	Ecuador	
	Peru	
	Uruguay	
	Venezuela	
Central America	Costa Rica	El Salvador
		Guatemala
		Honduras
		Nicaragua
		Panama
Caribbean	Antigua and Barbuda	Belize
	The Bahamas	Dominican Republic
	Barbados	Haiti
	Cuba	St Kitts and Nevis
	Dominica	St Lucia
	Grenada	St Vincent and the Grenadines
	Guyana	
	Jamaica	
	Suriname	
	Trinidad and Tobago	

Source: Bernal (2015)

2.6 As noted previously, following the internationalisation of Chinese firms, Chinese FDI flows to the Caribbean have steadily increased. Notwithstanding, both China's share of OFDI into the Caribbean and the share of the Caribbean in China's total OFDI are quite small and as such there is room for improvement. Based on interest from China, all indicators suggest increased Chinese FDI flows to the Caribbean, moving in line with traditional sources from USA, Canada and the United Kingdom. As can be seen in Table 2, since 2005 most BMCs have had an increased stock of Chinese FDI, some of which have been substantial, such as the cases of Guyana, Suriname and Jamaica. Table 3 gives a brief description of OFDI flows in selected BMCs. There is a wide range of interest areas in these countries as can be seen. These include mining, transportation, agriculture, energy, tourism, information technology and general infrastructure development. The remaining BMCs have much lower emoluments of Chinese FDI, both in terms of stock and inflows. Some countries such as Saint Lucia, Haiti and St. Kitts and Nevis have been unable to garner OFDI flows from China due to their political relations with Taiwan.

2.7 Given the current drivers of Chinese OFDI flows globally, one could fairly assume that there are opportunities aplenty in the Caribbean for OFDI flows. Based on Table 3 resource or raw material seeking (in the areas of crude oil and bauxite) have seemingly been the key drivers so far. The recent crude oil finding in Guyana represents a key development which may trigger significantly increased OFDI flows. As the Chinese economy continues to emerge, average income should continue to rise along with the population size, resulting in food demand increase. This issue could be alleviated by investments in BMCs such as Guyana, Suriname and Belize where there is vast fertile land available for food crop production. Chinese need for timber could also be provided by these countries. Of course, BMCs also represent geographical advantages in terms of their close proximity to the US market as a transshipment point, as well as preferential trade agreements with the global economy. Chinese interest in establishing foreign ports is also well documented. In addition to the port in the Bahamas, there is interest in setting up a logistics hub by upgrading the port of Kingston in Jamaica. China uses over 40% of the world's aluminum production according to the Economic Commission for Latin America and the Caribbean (ECLAC, 2012) and as such is heavily interested in OFDIs for that purpose. In addition to the present energy-related investments in Jamaica, Guyana and Trinidad and Tobago, Chinese companies have continuously shown willingness for further investment. This will only be further intensified following the recent discovery of oil reserves in Guyana. In addition, China is currently the world largest producer of rare earth metals (McFadden [2013]), but there has been a recent shortage that could be alleviated by investments in Jamaica, where potentially, rare earth metals could be extracted from the alumina plants in the country (Bernal [2016]).

2.8 The BMCs have a strong appeal as it relates to alcohol (rum), coffee and particular food items that are supported by very attractive brands. Chinese companies have been known to be interested in acquiring famous international brands as a way to penetrate markets, rather than try to establish and market an entirely new brand. In this context, Caribbean brands of rum and coffee products are appealing which may attract strong flows in OFDI. There could also be interest on the part of relatively new business models for Chinese firms in the areas of tourism and education. As it relates to tourism, Chinese firms have begun to buy with great intensity, luxury properties in the USA and Europe, which could translate to interests in luxury resort accommodations in the some BMCs. As it relates to education, Chinese universities could be set up in some BMCs with the benefit of foreign currency inflows and growth impetus, as well as newly accessible scholarships for local students. This is currently being done in some BMCs with American medical universities. The same could be done for Chinese universities, particularly in the area of science, computer and technology. There is also the case that new business lines (or supply chains) can be opened due to the strong transnational ethnic business networks. For example, the strong business community of Jamaicans of Chinese descent living in Jamaica, has encouraged China to increase efforts in improving political relations. It has also had the benefit of allowing not only Chinese-Jamaicans, but Jamaicans that are not of Chinese descent to establish supply chains with China, to the extent where the number and range of Chinese imports have grown and are no longer dominated by Chinese Jamaicans (Bernal [2016]).

2.9 Of course, BMCs are not free of problems, varying from institutional weaknesses to cultural and social-economic issues. It is important that these are highlighted so as to design a strategy of efficiently targeting problematic areas with critically thought out solutions. First and foremost is the issue of some BMCs political relations with Taiwan, namely, Belize, St. Kitts and Nevis, Saint Lucia and St. Vincent and the Grenadines. Another issue relates to the often argued case that there is no clear strategy for attracting and then accommodating Chinese OFDI to the Caribbean. While some BMCs are more advanced in this context some are void of any strategy. For the vast majority of BMCs, efforts have been limited to promotional missions rather than a sustained and planned campaign (Bernal [2016]), with the one exception in Jamaica where bureaucratic process of issuing visas for business travel to Jamaica has been removed to accommodate efficient exchange with Chinese investors. Additionally, the overall business environment would need to be tweaked to accommodate Chinese firms, most of which have limited experience operating in the Caribbean. Chinese OFDI and, to lesser extent, foreign investments in general, have tended to solicit strong anti-foreign or pro-nationalistic feelings amid controversies surrounding the design of the investment agreement. It is important that all stakeholders are involved in the negotiations to ensure that such feelings are minimised. Regarding the issue of labour, this is twofold. Chinese investments is oftentimes conditioned upon the acceptance of some amount of Chinese labour. While this should not be to the detriment of qualified local labour, labour cost efficiencies can be a conflicting issue in some cases.

2.10 Against this background, it is important for BMCs' Governments to identify the right FDI projects that are congruent with national strategy and policy. It is also important that investments are tailored to be mutually beneficial, in particular for the enhancement of the home country labour and industries. Notwithstanding, the actual business environment is crucial to maximising the benefits of FDI, irrespective of how perfectly an investment project is concocted in terms of design and potential mutual benefit. The business environment must be able to reap these benefits and meet the potential of the intended project. In addition, BMC governments cannot be held to ransom by foreign investors and, in that regard, standards must be met with proper due diligence. Bad investments should not be tolerated for the sake of having investments. It is important that this is maintained to induce credibility and trust so as to allow the public to fully buy into the execution of the national plan and strategy for growth *via* FDI.

TABLE 2: CHINESE FOREIGN DIRECT INVESTMENT STOCK IN THE CARIBBEAN BY COUNTRY 2005–2013 (USD mn)

Country	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Antigua and Barbuda (PRC)	0.4	1.3	1.3	1.3	1.3	1.3	4.8	5.5	6.3
Bahamas (PRC)	14.7	17.5	56.5	0.6	1.6	1.6	1.6	0.6	0.6
Barbados (PRC)	1.7	2.01	2.4	3.3	6.0	3.9	3.1	4.0	5.0
Belize (ROC)	-	0.02	0.02	0.08	0.08	-	-	-	0.35
Cuba (PRC)	33.6	59.9	66.5	72.1	85.3	70.0	146.4	135.7	111.3
Dominica (PRC)	-	0.7	0.7	0.7	0.7	4.15	8.2	8.2	8.5
Dominican Republic (ROC)	-	-	-	0.6	0.12	0.12	0.1	1.1	1.1
Grenada (PRC)	-	4.0	7.5	7.65	7.65	14.25	14.5	14.5	14.5
Guyana (PRC)	5.6	8.6	68.6	69.5	149.6	183.7	135.1	151.9	225.2
Haiti (ROC)	-	-	-	-	-	-	-	-	-
Jamaica (PRC)		0.02	0.02	2.16	2.16	4.37	39.1	74.9	79.7
St. Kitts and Nevis (ROC)	-	-	-	-	-	-	-	-	-
Saint Lucia (ROC)	-	-	-	-	-	-	-	-	-
St. Vincent and the Grenadines (PRC)	12.3	14.92	20.8	32.5	23.0	36.2	36.2	36.2	36.2
Suriname (PRC)	13.02	32.21	65.3	67.7	68.8	78.8	78.8	45.6	111.9
Trinidad and Tobago (PRC)	-	0.8	0.8	0.8	0.8	0.8	0.9	1.1	3.9
Caribbean	81.2	142.0	290.4	258.8	347.1.	398.1	468.9	479.2	604.5
Caribbean without Cuba	47.6	82.1	123.9	186.8	262.8	332.5	322.5	343.5	493.2

Source: Bernal (2016).
PRC: Diplomatic relations with the People's Republic of China.
ROC: Diplomatic relations with the Republic of China (Taiwan)

TABLE 3: CHINESE FOREIGN DIRECT INVESTMENT IN THE CARIBBEAN BY COUNTRY, COMPANY, SECTOR AND VALUE (USD)

Country	Company	Sector	Investment (USD mn) Value	Date
Guyana	Bosai Mining[a]	Mining investment	100	2006
	Haier Computer Store[b]	Computer service Center		2012
		Computer and television assembly plant	10	Deferred indefinitely
	Bai Shan Lin/China Forest	Forestry		
	Industry Group[c]	Wood processing Factory	70	Delayed
		Gold mining		2014
		Housing and mall development		2014
	Datang[d] (20% shares in GT&T)	Telecommunications	30	2012
Jamaica	Xinfa[e]	Mining	In discussion	
	China National Complete Plant Import-Export	Agriculture (cane farming)	156	2011
	Corporation[f]	Manufacturing (sugar)	9	2011
	China Harbour Engineering	Transport	600	2014
	Co[g]	Tourism–hotels		
Suriname	China Zhong Heng Tai Investment[h]	Agriculture/mfg (palm oil)	4.5	
Trinidad & Tobago	Chaoyang BVI (25.5% share)	Energy (oil production)	0.78	2009
	China Investment Corporation	Energy (natural gas)	850	2011
	China Investment Corporation (30% share)	Energy (exploration)	In discussion	
	ENN[i]	Energy (compressed natural gas)	Memorandum of Understanding (MOU) signed	2014
	SINOPEC/SABIC JV[j]	Alternative energy (methanol)	Aborted	
The Bahamas	China State Construction Engineering[k]	Tourism	N/A	2014
Antigua	Yida International Investment Group[l]	Tourism	$1bn	2015

Sources: Bernal (2016)

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j. Ellis, R. E. 2014. China on the Ground in Latin America. Challenges for the Chinese and Impacts on the Region. New York: Palgrave Macmillan.
k. "Nassau's British Colonial Hilton Sold." Available at: http://www.caribjournal.com/2014/10/27/nassaus-british- colonial-hilton-sold/#
l. "Soil Turned, Jobs On." Antigua & Barbuda News, 1 May 2015.
OECD (2014) mentioned regarding FDI statistics

Development of trade between China and the Caribbean

2.11 Following the Global Financial Crisis in 2008, Latin American and Caribbean (LAC) countries have increasingly looked for trade and investment partners outside their traditional markets in North America and Europe. Increasingly, nations have looked to Asia in order to make up for part of their lost global market share, as emerging Asian nations such as China have tried to expand their sphere of influence to the Americas. Following the recent abandonment of the Trans Pacific Partnership (TPP) by the new USA administration, China has become even more attractive as a potential trade and finance partner for the Region. Chinese trade imports mainly consist of raw materials and agricultural products, while Chinese exports increasingly consist of high-tech goods, such as automobiles, trains and computers and cell phones. Latin American nations with resource endowments are the main winners of trade with China. For BMCs this could imply that commodities exporters such as Belize, Guyana, Jamaica Trinidad and Tobago and Suriname have the most to gain from increasing trade linkages with China. This, however, will as well depend on future commodity market cycles. Following the demise of TPP, China's plan to establish the Regional Comprehensive Economic Partnership (RCEP), expected to result in a free trade area comprising 3.4 billion people, could further push international trade between Asia and the Americas, as countries from the Americas are reported to have expressed their interest in joining RCEP[1].

2.12 In 2016, China's merchandise exports to Latin America tumbled by 13.8% to USD113.9 billion (bn), Chinese imports from the Region declined just by a slight 1.1% to USD102.7 bn according to China News Service, citing the Chinese Ministry of Commerce's (MOFCOM) website. The economic meltdown in Latin America has probably lowered the appetite for Chinese manufacturing goods in 2016. The export structure of Latin American countries towards China indicates a concentration mainly in minerals, fossil fuels and agricultural products, all products whose prices have slumped in 2016. The maturing of China's economy means there might be less Chinese demand for primary commodities, but more for demand for tourism and other services in the future. On a negative note, this might imply that the complementary relationship of trade between China and Latin America might be vanishing, potentially eroding the political appetite for future trade deals. Total China – Latin America merchandise trade stood at USD216.6 bn in 2016, which represents 6% of China's total foreign trade, a clear increase from 2.7% in

[1] Sixteen nations including, among others, Australia, China, India, Indonesia, Japan, South Korea and Vietnam have signed up to RCEP. Following the demise of TPP, Central and South American nations might be interested in joining RCEP, as Chile and Peru have already expressed their interest.

2000[2]. Regarding trade with Caribbean nations and the BMCs, the Caribbean so far has been suffering from poor trade connectivity. IMF (2017 A) states that *"… the Caribbean remains at the periphery of the world trade network …"*, which implies that a very proactive approach to promote trade with China, in conjunction with a rise in international competitiveness and an improved ease of doing business is necessary to improve BMCs' trade prospects. For BMCs for which data is available, total merchandise trade with China, which includes imports and exports, increased from USD167 mn in the year 2000, to USD1,731 mn in the year 2014, which corresponds to a 18.2% annual growth rate. While the BMCs' trade deficit with China has grown from USD149 mn in 2000 to USD1,446 mn in 2014, annualised export growth at 22.9% has outpaced import growth at 17.8%. All BMCs – including the commodity exporters - displayed trade deficits towards China in the year 2014, as they had done already in the year 2000. Future research into the development of trade figures between China and BMCs should aim at analysing the effect of trade on employment levels, wage levels and the income distribution in the single BMCs. The Inter-American Development Bank (IDB [2017]) reports that commodity exporters were the main beneficiaries of the China-Americas trade in the 2000s. Higher income from commodities generally allowed commodity exporters in Central and South America to raise social spending and to reduce income inequality.

2.13 Bilateral data on services trade instead is still very piecemeal, even between BMCs and their trading partners in OECD. Traditionally, data on goods trade has readily been available due to the need to calculate tariffs on merchandise, while the intangibility of services led to difficulties in recording statistics on services trade. Currently, services trade data between China and BMCs is only available for some BMCs for the Information Communications Technology (ICT) sector. However, mainly tourism linkages are expected to grow in the future as China increasingly engages with the Caribbean, as also displayed by its recent official paper titled "***China's Policy Paper on Latin America and the Caribbean***" (PRC, 2016). In this paper Chinese authorities stressed their goal of promoting two-way tourism between China and the Caribbean. China will increase its support for direct flights between the two regions as airlift currently remains the main problem for travel between China and the Caribbean[3]. An official trip of Miami-Dade County to China in 2016 showed that three Chinese airlines are potentially interested in flying directly to Miami, which would reduce travel time between China and the Caribbean, although much more needs to be done to improve the Caribbean tourism product in order to entice more Chinese visitors to come to the Region. Measures would include offering more luxury accommodation, increasing levels of security, hiring of Mandarin and Cantonese speakers, enhancing the offerings of Chinese cuisine and improving the shopping experience for Chinese visitors. Miami-Dade expects the Chinese middle-class to grow to 630 million, or 45% of total Chinese population, by 2022, implying that increased airlift could considerably raise the number of expected tourist arrivals from China in the Caribbean (Miami Today News, 17 May 2016). The United Nation's shipping connectivity index further backs up IDB's finding that BMCs' economies are poorly connected to major global trading partners, a situation which needs improvement to promote growth in goods and in services in general. For the year 2016, the USA and the UK display connectivity indices between 0.73 and 0.76 with China, while most BMCs have connectivity indices comprised between 0.1 and 0.2, with only Jamaica, Bahamas and Trinidad and Tobago reaching a connectivity value in the range between 0.4 and 0.5. The figures are based on connectivity ranging from 0, indicating no connectivity to 1, implying perfect connectivity.

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[2] All trade data for paragraphs 2.3.2 and 2.3.3 was retrieved from UN COMTRADE on April 22, 2017, unless otherwise specified.

[3] The only airlift available so far between China and the Caribbean is a service Air China has been providing since January 2016, connecting Beijing to Havana via Montreal three times a week.

Chinese Development Assistance in the Region

2.14 China is an emerging donor with a different model of dispensing aid than the traditional donors of OECD Development Assistance Committee (DAC). Typically Chinese development assistance is neutral with respect to the type of political regime governing the recipient country, as well as the type of economic and social policies the recipient country chooses to pursue. As a result Chinese development assistance is dispensed with less conditionality (Bernal, 2015). China's development assistance comes in the form of grants, loans, lines of credit, technical assistance and in-kind donations and in more recent times has taken the form of debt forgiveness. For example, in 2007 China granted the Government of Guyana USD15 mn in debt forgiveness for a loan from China's EXIM Bank and, prior to that, in 2003 China granted Guyana USD20 mn in debt relief (CARU, 2003; BBC, 2007). In 2005 China provided USD87 mn to the Caribbean, the largest recipients being Suriname (USD23.6 mn), Jamaica (USD16.3 mn), Belize (USD10.1 mn), Guyana (USD9.9 mn), and Dominica (USD9.3 mn) [Bernal, 2015]. Data suggests that China's development assistance has increased considerably over the last two decades. This dramatic increase in aid occurred within a broader context of increasing Chinese development assistance to developing countries, particularly countries in African. Since the 1999 "Going Out Strategy" in addition to expanding its foreign investments, China has also increased its overall development assistance. Lunn, Gomez-Granger, and Leland (2009) state that China raised its aid from USD1.5 bn in 2002 to USD25 bn in 2007.

2.15 On January 20, 1998 China joined CDB. Ten years later China became a member of IDB. China holds about 5.64% of CDB's total shares and it has contributed USD7 mn to the 8th replenishment of the Unified Special Development Fund. More broadly, China committed funds for several development projects in LAC such as the USD2 bn IDB-China Co-Financing Fund for Latin America and the Caribbean aimed at promoting sustainable growth. In addition, China has provided financing for a LAC-China infrastructure fund.

2.16 As discussed in earlier in this section, in the context of a rivalrous relationship with Taiwan, China has used development assistance as the primary instrument to achieve influence and expand diplomatic relations in the Region. Development assistance is the cornerstone of Chinese foreign policy in the Caribbean. In cases where countries switch diplomatic relations from Taiwan to mainland China in favour of the One-China policy, China has rewarded those countries in substantive ways. For example, Dominica received a USD17 mn cricket stadium, as well as future commitments (Fieser, 2011).

SECTION 3

3. LESSONS FROM COUNTRY USE OF RENMINBI

Experiences of countries that use Renminbi

3.1 The evolution of RMB cross-border use began with Hong Kong. Hong Kong residents, as early as 2004, were permitted to purchase yuan with daily limits (Kasikorn Research Center, 2011). In 2009, China established the dim sum bond market[4] and expanded the Cross-Border Trade RMB Settlement Pilot Project. Just prior to this in 2008, the People's Bank of China (PBC) permitted RMB use outside of China for all current account transactions and certain capital account transactions subject to approval. This policy action was a step in the direction of full convertibility and opened avenues for other countries to use RMB.

3.2 In 2008 the expansion of the Cross-Border Trade RMB Settlement Pilot Project saw the inclusion of the Association of South East Asian Nation (ASEAN) countries as eligible for settlement in RMB. The year after, China signed swap agreements with several countries such as Argentina, Brazil, Canada, Indonesia, South Korea, Thailand, and UK among others, which began the process of international clearance and settlement in RMB, creating the foundation for further development of bond and other securities markets in RMB (Kasikorn Research Center, 2011).

3.3 RMB is used to settle approximately 18% of China's total trade and well over ten thousand financial institutions use RMB to conduct their business. Today China has swap agreements with 35 central banks and there are PBC-designated RMB offshore clearing centres. In the future it is likely that China will begin to further develop and increase access to its onshore markets allowing foreign investors much greater access to domestic capital markets which by default are RMB markets.

3.4 Suriname is an example of a developing country that signed a RMB swap agreement with China on March 18, 2015. The total maximum value of this swap was 1 billion yuan. The objective of the swap agreement in Suriname was to improve access to foreign exchange for importers of Chinese goods (trade facilitation). Given that the imports from China accounted for USD224 mn in 2014 or 11% of Suriname's import bill, this swap agreement brings considerable relief to importers traditionally exclusively dependent on the availability of US dollars to facilitate trade (Economist Intelligence Unit. 2015). Naturally, reduced demand for US dollars positively impacted the fixed exchange rate band since it reduced speculation against the Suriname dollar.

3.5 The 100 RMB notes are now common place in commercial exchanges in Suriname, precisely because of the currency agreement (China Daily, 2016). Moreover, in roughly the same time period as the agreement, China UnionPay, in consortium with the Southern Commercial Bank and the De Surinaamsche Bank (DSB), introduced UnionPay prepaid cards. UnionPay is already accepted globally, but what is special regarding Suriname when compared to other BMCs is that Surinamese residents can be issued UnionPay cards. China UnionPay is one of the fastest growing card systems in the world and it is accepted in over 140 countries (Southern Commercial Bank, 2015). China UnionPay accounts for about 7.7% of worldwide card transactions (China Daily, 2015). Given the relatively undeveloped nature of financial markets in Suriname, the introduction of UnionPay services was an interesting experiment to determine the compatibility of UnionPay systems with such markets. Suriname is currently the only CDB BMC that is at a relatively advanced stage in RMB usage. All indications are that UnionPay has been well received in

[4] Named after a popular Hong Kong style of cuisine, the dim sum market is a market where bonds denominated in Chinese RMB(also referred to as dim sum bonds) are issued and traded.

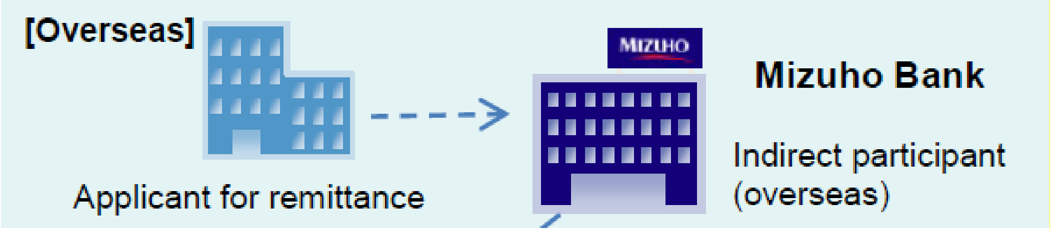
Suriname and demand is growing. DSB Chief Executive Officer Mr. Proeve stated that "*UnionPay is an excellent alternative for both business travelers and tourists*". He went on to state they intend to bridge the rest of the Caribbean and South America with this card (Southern Commercial Bank, 2015).

How are international payments conducted in Renminbi?

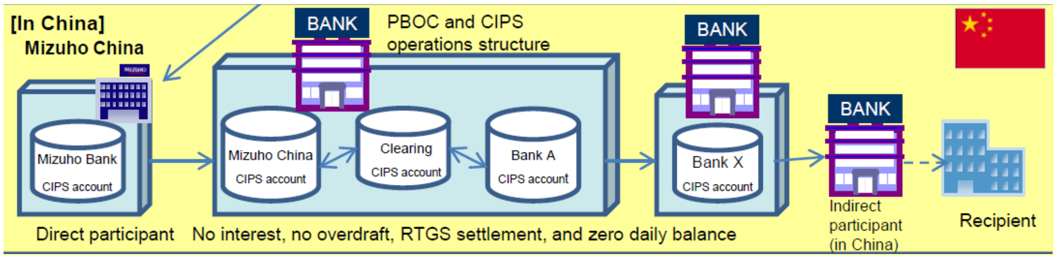
3.6 The speed of RMB internationalisation has picked up pace over the last decade although RMB is not fully convertible due to capital controls[5]. In an effort to internationalise the currency, PBC has signed bilateral currency swap agreements with 35 overseas central banks and monetary authorities - including the Central Bank of Suriname – by February 2017 (RMB Global Advisors, 2017). While the traditional purpose of a currency swap agreement is the provisioning of foreign exchange liquidity during times of crises, the swap agreements with PBC will help foreign countries to gain increased access to RMB liquidity in general. RMB clearing arrangements, facilitating invoicing, settlement, investment and financing in RMB, were set up by PRC with 23 countries and territories (so-called RMB offshore centres) in which PBC-designated RMB clearing banks with onshore RMB access are present (RMB Global Advisors, 2017). Typically, PBC designates one clearing bank per jurisdiction. In 2014, Canada became the first country in the Americas with a designated RMB clearing bank, which is Industrial and Commercial Bank of China (ICBC) and in 2015 China Construction Bank (CCB) was designated as RMB clearing bank for Chile, a first for Southern America.

3.7 In a major step forward for RMB internationalisation, PBC set up the Cross-border Interbank Payment System (CIPS), providing clearing and payment services in RMB across borders. As displayed in Figure 1, in this system, Chinese and foreign banks hold CIPS accounts through which funds denominated in RMB are channeled between customers located outside China and customers located in China. Having been initially built as a standalone system, CIPS operations structure was linked up to the Society for Worldwide Interbank Financial Telecommunication (SWIFT) messaging system in 2016. It conforms to the relevant International Organization for Standardization (ISO) standards, and covers the Chinese, European/African and Oceania time zones, although it does not yet cater for the time zones of the Americas. CIPS seeks to rectify deficiencies in the payment structure for cross-border RMB payments and has significantly increased efficiency and lowered transaction costs in a system which was widely known for a patchwork of clearing hubs and correspondent banks. These previous system of cross-border transactions was plagued by complicated routing procedures, the need for multiple foreign correspondent accounts, different operation hours between clearing centres and a lack of common standards between international and domestic payment systems (Federal Reserve Bank of San Francisco, 2016). CIPS is likely to play a critical role in RMB's future growth as an international payments currency.

FIGURE 1: <u>EXAMPLE OF CROSS-BORDER RMB SETTLEMENT USING CIPS BY MIZUHO BANK</u>[6]



[5] IMF (2016): For example, PRC has controls for payments for invisible transactions, as well as for current transfers and for personal capital transactions in place.
[6] Mizuho Bank is one of 11 overseas financial institutions participating in CIPS, together with 16 domestic institutions.

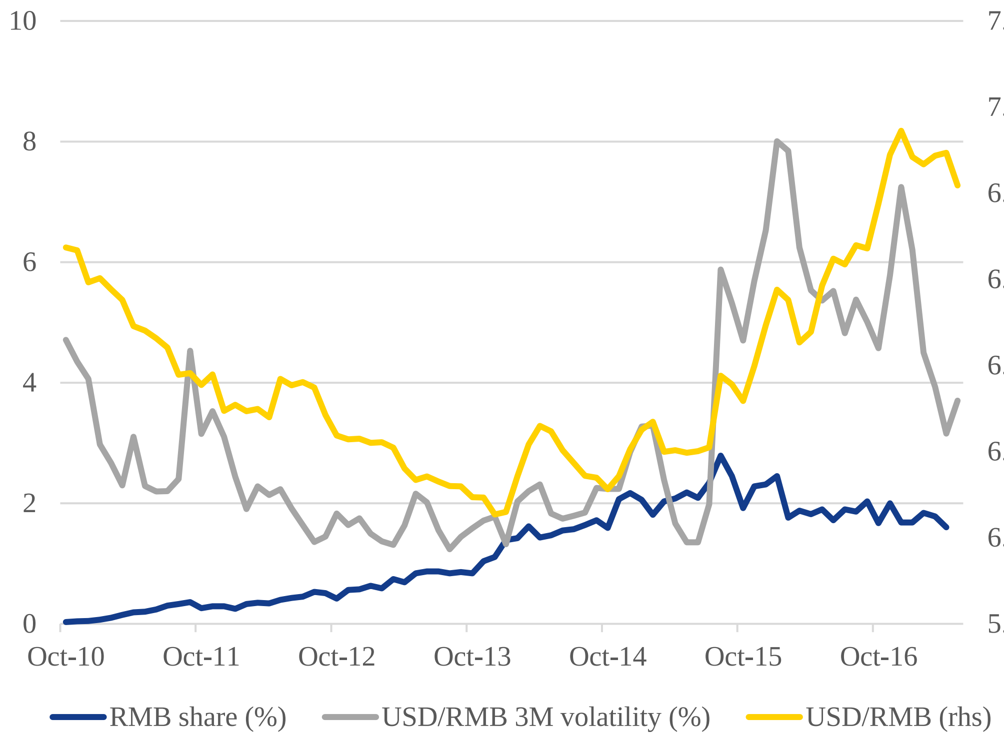


Source: Mizuho Bank

3.8 The inclusion of RMB as one of five currencies in IMF SDR currency basket in 2016 marked a further milestone in RMB internationalisation. The inclusion is expected to further enhance the acceptance of the Chinese currency as a major global currency in trade and in trade finance. According to the monthly SWIFT RMB tracker, the share of RMB in the total value of international payments has strongly increased since 2010[7]. Between December 2010 and August 2015 the share of RMB in global payments increased from 0.1% to 2.8%, although by April 2017 it had declined again to 1.6% (figure 2). RMB has moved from being ranked the 33rd most-used currency in global payments in 2010 to being ranked 4th in August 2015, although slipping back to 7th since then. As of November 2016, the RMB was also ranked 3rd for international trade finance with a share of 4.2%, which however is a decline from being ranked 2nd with a share of 8.7% in October 2013. Looking at these statistics, the use of RMB so far seems to have peaked in summer 2015. The relative decline in the use of RMB since then might be attributable to the slow-down of economic growth in China and smaller Chinese current account surpluses (refer to Figure 3), although trade surpluses remained relatively high until 2016. Lower current account surpluses may have been interpreted by businesses and by financial markets as a lower foreign-exchange (FX) earnings capability of the Chinese economy and, as such, might have lowered the attractiveness for RMB use and the desired degree of RMB exposure, amid increased macroeconomic uncertainty. Increasing uncertainty regarding the sustainability of economic growth rates in China has triggered capital outflows (Figure 4) leading to a reduction in PBC's FX reserves from USD4 trillion (tn) to USD3.1 tn (Figure 5) as PBC has tried to stabilise the exchange rate of RMB, accepting a drawdown on FX reserves. While PBC overall has contributed to stabilising the exchange rate, it has also allowed the currency to slightly depreciate versus the USD. 2014 has seen the end of a 20-year long appreciation period of RMB versus USD, which has led to bouts of exchange rate volatility in the currency pair (Figure 2) and an increase in hedging costs of RMB exposure. The increased macro-economic uncertainty regarding economic growth, developments of capital flows, the exchange rate and FX reserves, have probably contributed to the relative decline in the international use of RMB since 2015.

[7] SWIFT data do not include all payments between international financial institutions as these institutions have additional means of communicating payments.

FIGURE 2: RENMINBI SHARE IN SWIFT PAYMENTS, USD/RMB EXCHANGE RATE THREE-MONTH IMPLICIT OPTIONS VOLATILITY AND USD/RMB EXCHANGE RATE (RIGHT-HAND SCALE)



Source: Caribbean Development Bank, Bloomberg

SECTION 4

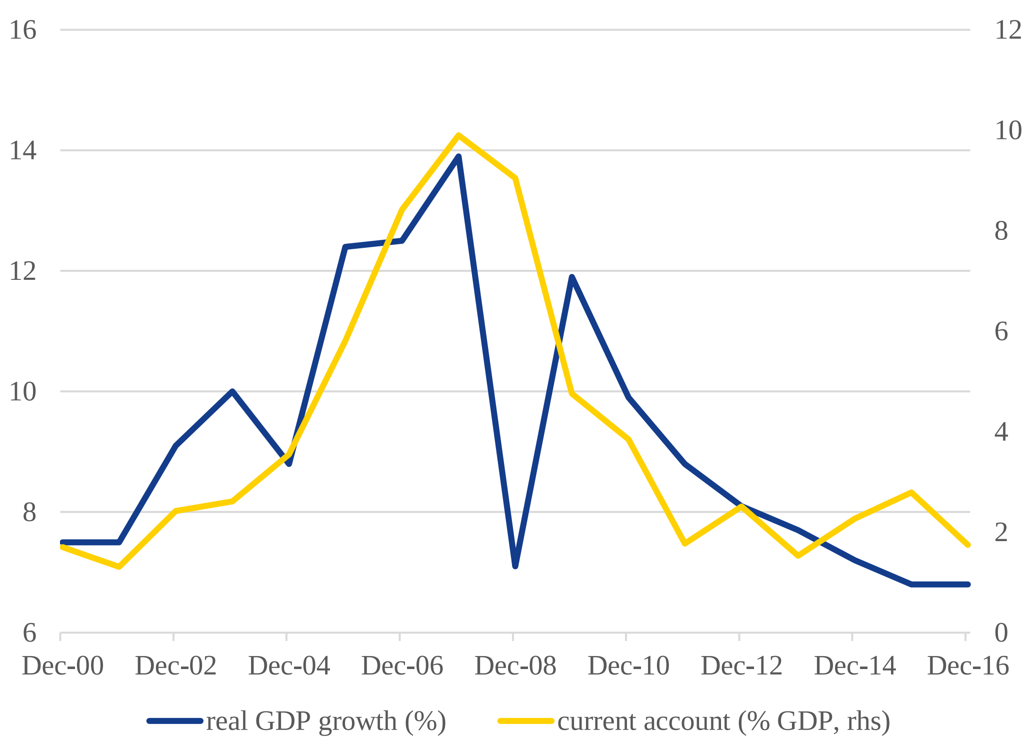
4. POTENTIAL OPPORTUNITIES AND RISKS

Trade facilitation

4.1 Sixteen of CDB's BMCs have populations under one million people and are classified as small states. Small states typically have a ratio of trade to GDP that is 54 percentage points higher than the average economy (Easterly and Kraay, 2000). This high level of openness has contributed to their growth performance over the last five decades (Easterly and Kraay, 2000). RMB use, as well as payment and settlement arrangements that facilitate RMB use provide an opportunity for facilitation of trade in merchandise goods, as well as services.

4.2 RMB trade settlement brings with it several advantages such as lower foreign exchange conversion costs since it no longer becomes necessary to use a vehicle currency to facilitate China trade. Companies outside of China are likely to have a greater ability to negotiate better prices from their counterparts in China if they have the ability to settle terms in RMB (Standard Chartered and Thomson Reuters, 2014). Moreover, according to PBC surveys, Chinese exporters are possibly prepared to offer discounts as significant as three percent if the purchasers pay in RMB (Standard Chartered and Thomson Reuters, 2014). Another key advantage for more efficient firms is that renminbi use potentially enables greater access to markets in China. Many of the cost implications involved depend on the flexibility of the trade financing facilities and the scope for use of hedging tools.

FIGURE 3: CHINA'S REAL GROSS DOMESTIC PRODUCT (GDP) GROWTH AND ITS CURRENT ACCOUNT SURPLUS IN RELATION TO GDP



Source: Caribbean Development Bank, Bloomberg

4.3 Making RMB a viable currency for international trade is at the very core of RMB internationalisation efforts. China's trade with the rest of the world is expected to grow significantly over the next decade. As Caribbean trade with China expands so too will the potential benefits of RMB use. RMB use itself has the potential to expand trade and growth opportunities as well, particularly trade in services. A useful caveat though is the fact that the growth in China trade has been somewhat unbalanced with significant level of imports from China accompanied by a vastly smaller volume of exports from BMCs with only tepid increases annually. This trend is likely to continue and increase the trade deficit of the Caribbean with China as Caribbean consumers become more accustomed to Chinese products. RMB use, however does offer increased potential for efficient exporters, particularly in high value products such as coffee, rum, fish, lobster, and shrimp (Bernal, 2015). As Chinese incomes grow and Chinese tourists look beyond Southeast Asia and Europe, the Caribbean stands to gain from increased arrivals.

Improved access to global financial services

4.4 As de-risking continues to pose a significant threat to developing economies, the issue of access to global financial services has become even more pronounced for BMCs. Importantly, BMCs that are the recipients of FDI flows or trade denominated in RMB can now conduct transactions using correspondent banking relationships (CBRs) from Chinese banks through CIPS, alleviating the need for traditional CBRs underpinned by a western banking network. This crucial change in the financial infrastructure of trade and investment is an important development for BMCs that have lost some amount of traditional CBRs. This point is further reinforced when one considers that there has been an exponential growth in CBRs underpinned by Chinese banks, diametrically opposite to the trend for traditional CBRs underpinned by western banks. However, this leads to the question; how are CBRs for Chinese banks unaffected by the same de-risking motivations by western banks and how has this worked to increase BMCs access to global financial services?

4.5 The broad implications of de-risking are the loss or decline in access to global financial services to conduct trade and investment. This is crucial to any economy, however trade tends to be even more crucial for small open economies of the Caribbean. Therefore, the Caribbean region is uniquely susceptible to the effects of de-risking, particularly due to its dependence on trade, remittances and FDI. While trade amounts to one-third of the USA's GDP, trade is equivalent to almost half the GDP of developing countries of LAC and almost 100% of GDP in small Caribbean states. De-risking therefore remains one of the most important risks facing BMCs simply due to the fundamental need for consistent and predictable access to global financial services *vis-a-vis* an efficient banking network of CBRs.

4.6 The US dollar is used for 44.6% of all world payments, followed by the Euro at 28% and the British pound (£) at nearly 7.9%. In 2015 RMB was the 5th most used currency in international payments, according to the SWIFT network responsible for international financial transactions with 2.8%, although as noted before, this share dropped to below 2% in 2016. At the same time, data shows that since 2009, Chinese banks increased their CBRs from 65 to 2,246 in 2016, while the overall global trend was a 25% decline.

4.7 A key contributor to this differing trend has to do with the regulations and fines imposed on Western banks versus Chinese banks. Western banks have frequently been fined (for example Deutsch Bank's £500 mn fine) for having risky exposure to CBRs in the context of Anti-Money Laundering/You're your Customer (AML/KYC) rules. It is argued that Chinese banks do not face the same regulatory pressures or the threat of heavy financial penalties imposed by US regulators. As a result, many lost CBRs by Western banks have been seemingly replaced by Chinese counterparts. While AML/KYC risks are still monitored by the Chinese banks, it is argued that the imposition of fines have been far less frequent and severe, leading to a less risk averse approach on the part of Chinese banks.

4.8 The establishment of CIPS has worked to promote increased internationalisation of RMB and increased CBRs by Chinese banks. This has collectively worked to increase access to global financial services for developing economies conducting trade and receiving FDI. The main purpose is to facilitate the use of RMB globally by cutting transactions costs and increasing efficiency. Currently 26 international and domestic banks are direct participants to the system. Previously, the processing of RMB globally was carried out over an inefficient network arrangement with SWIFT. The SWIFT network did not have a user friendly interface for the Chinese language creating connection issues with China's domestic interbank clearing and settlement system, namely, the China National Advanced Payment System (CNAPS). In March 2016, however, CIPS signed n MoU with SWIFT. This understanding was based on deploying SWIFT as a secure, efficient and reliable communication channel for CIPS' connection with SWIFT members. This in turn would provide a network that enables financial institutions worldwide to conduct transactions more efficiently with RMB.

4.9 This has the potential to enhance access to global financial services for BMCs that have lost traditional CBRs. Such BMCs now have the option to trade in RMB or USD and conduct such trades with Western or Chinese financing, using SWIFT and CIPS respectively, anywhere in the world where the platform is compatible. The number of participants of the CIPS system is ever increasing, along with the usage of RMB and CBRs by Chinese banks. China and its affiliated financial network of Chinese banks and clearing system have worked to increase the access of BMCs (both potentially and actually) to global financial services. Essentially, CIPS provides new channels for clients wanting to transact more efficiently in RMB without the issue of being exposed to excessive currency and liquidity risks brought about by the previous problems of transactions impediments due to inefficient clearing processes or lack of financial intermediaries' willingness to do business with an institution in one of the BMCs, or simply with using the RMB.

Currency, liquidity and systemic risks

4.10 Over the last decades, most BMCs have enjoyed relative macroeconomic and financial stability, which probably was also helped by the fact that most BMCs' national currencies were - and still are - pegged to the United States Dollar (USD). Currently, two BMCs use USD as legal tender, 12 have pegged their exchange rates to USD and only 5 have flexible exchange rate regimes versus USD that are managed by their respective central banks. Traditionally, currency risks and liquidity risks played a minor role as USD has been the world's main reserve currency and transaction currency and also BMCs' tourism revenues were largely in USD. This institutional set-up meant that as long as BMCs would not build up significant external and internal imbalances, there would be only limited currency, liquidity and systemic risk related to the exchange rate. On the contrary, a stronger movement to RMB could pose a threat to the business outlook in BMCs as it relates to these risks. Accordingly, the potential for the use of RMB in the Caribbean depends on whether RMB can provide similar benefits to the regional economies, which is provided by the use of USD. Some of the main requirements, which the private and the public sector traditionally look for in a reserve currency, are: (i) actual IMF reserve status of the currency, or factual use as a reserve currency by major central banks; (ii) existence of deep and liquid bond markets in the country issuing the currency; (iii) geo-political strength and political stability in the country issuing the currency; and (iv) the strength of the current account of the country issuing the currency.

4.11 Firstly, liquidity risk may depend on the extent to which RMB becomes a well-established reserve asset thereby ensuring an adequate supply of the currency. This also depends on the liberalisation of capital account in China which has still not occurred. Regarding its reserve status however, RMB was added to IMF's Reserve Basket as one of only five widely-used global currencies in 2016, following an IMF decision taken in the year 2015. While the inclusion into IMF's Reserve Basket gives official reserve status to RMB, the actual use of RMB as an international reserve currency still is very limited however. At the end of 2016, only the equivalent of USD85 bn of global central banks' reserve assets were allocated in RMB. This constituted only 1.1% of total global currency reserves which stood at USD7.9 tn, implying that acceptance of RMB as a reserve currency was still very low in 2016. The low degree of foreign exchange reserves held in RMB compares unfavourably to the amounts held in the Canadian dollar and in the Australian dollar, which stood at USD160 bn and USD146 bn, respectively, although neither of the two currencies is an IMF reserve currency. As RMB has been assigned reserve status by IMF only last year, more time is probably needed to see a more meaningful share of RMB held in central banks' global currency reserves. In the short-term, this share cannot be expected to rise as Chinese capital outflows are currently dominating capital inflows (Figure 6). Following strong inflows between 2010 and 2013, the quarterly capital account generally has been in deficit since 2014, as investors have become cautious regarding the outlook for the Chinese economy and the future development of RMB exchange rate. While liquidity risks have been contained given the recent internationalisation efforts, the slight fall in usage since August 2015 is not a step in the right direction and increases the probability of instability.

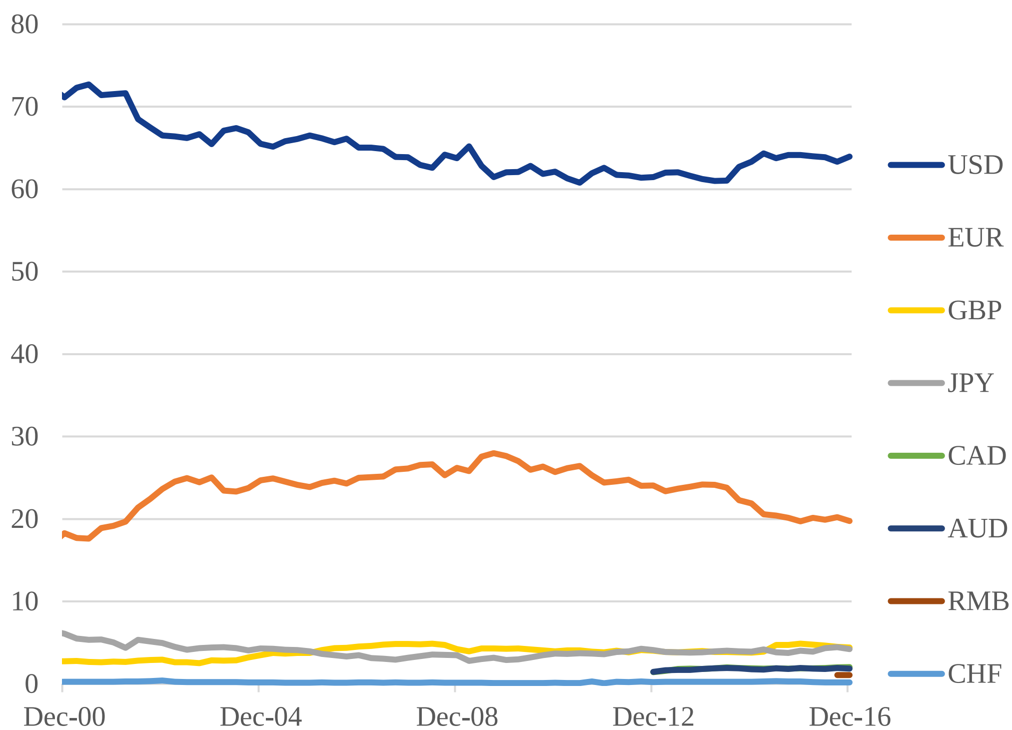
4.12 Potentially, there could also be currency risks when dealing with RMB. Currency risks are associated with exchange rate exposures and can usually be mitigated by hedging. However, once capital controls are in place, then an investor runs a significant risk of being exposed to unfavorable exchange price movements that cannot be mitigated against under capital controls. Regarding the state of the Chinese capital markets, these are deep and liquid, but not fully accessible to foreign investors, which limits foreign investors' desired degree of exposure. Foreign exchange convertibility is not fully guaranteed as some capital account transactions are subject to foreign exchange control. Although this limits the flexibility of the use of RMB in international financial markets, current account transactions are not liable to foreign exchange restrictions. Also, RMB deposits are not subject to foreign exchange restrictions.

4.13 Concerning the geo-political dimension, China is currently one of the most powerful nations in the world when measured by most standards and from an economics point of view it is the second biggest world economy behind the US, contributing 14.9% to global nominal GDP in 2016 according to IMF (2017 B), compared to the 24.7% contributed by the US. Extrapolating IMF's (2017 B) projected 2015-2022 nominal GDP growth rates, which stand at 6.7% for China and at 4.% for the US, China would surpass the US in 2034 and become the biggest global economy. Given, the size of the Chinese economy, the size of its population, its geo-political power and China's involvement in major global organisations such as the Group of 20, IMF, the World Trade Organization, and the Bank for International Settlements, its currency should easily qualifying for a top spot among major global reserve currencies.

4.14 A country's current account in some instances has been cited as an important characteristic of its currency's reserve status. Countries staging current account surpluses, such as Japan, Germany and Switzerland have traditionally enjoyed stable and generally appreciating currencies and high financial stability, although the Swiss franc is no official IMF reserve currency. The US dollar, which is one of five currencies with official IMF reserve status has, however, become the most widely used international reserve asset, notwithstanding large and persistent US current account deficits, by virtue of the size of the US economy and the USA's strong geo-political power. RMB's chances of becoming an important global reserve currency will as well depend on China's capability of recording future current account surpluses, as these would tend to stabilise the value of the currency.

4.15 For the best part of the 21st century, the gradual opening up of the Chinese economy, the development of China's financial markets and the internationalisation of RMB have led to great expectations regarding the future performance of Chinese financial markets and RMB. The PBC has introduced several measures to liberalise the USD/RMB exchange rate since 2005, which together with the strong growth rates of the Chinese economy, capital inflows into China and financial market expectations about further RMB appreciation have helped RMB to appreciate from close to 8.30 yuan per USD at the start of 2005 to close to 6 yuan per USD in December 2013. Since then, however, a more balanced or conservative assessment of the future opportunities and risks of doing business and investing in China, has prevailed. First of all, growth rates in the Chinese economy have declined from 8.1% in 2012 to 6.8% in 2016 (please refer to Figure 3). Secondly, capital flows towards emerging markets in general, and China more specifically, have weakened and eventually have become negative for China (please refer to Figure 5). The reasons for the capital outflows from China are manifold, but important contributing factors were tumbling commodity prices, anticipation of the start of the interest rate hiking cycle in the US and strongly falling Emerging Market currencies between 2014 and 2016. Indeed, RMB also fell to close to 7 yuan per USD by the end of 2016, before stabilising slightly during the first six months of 2017 at levels close to, but below 7 yuan.

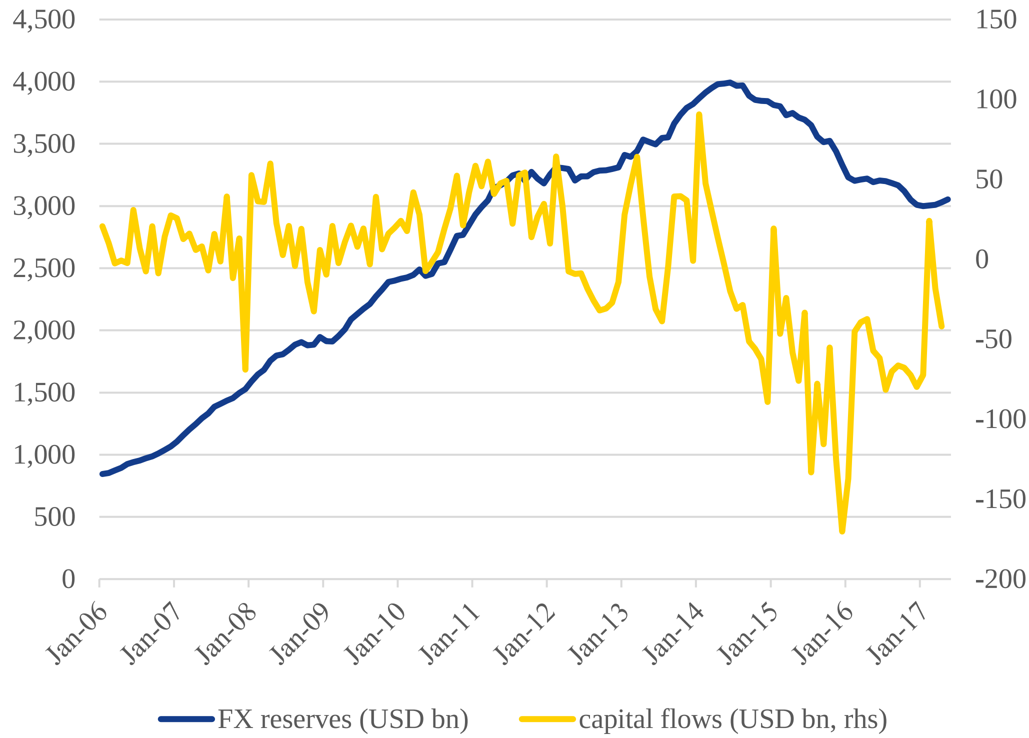
FIGURE 4: PERCENTAGE OF EACH CURRENCY HELD IN TOTAL GLOBAL CENTRAL BANK CURRENCY RESERVES



Source: Caribbean Development Bank, Bloomberg

Note: Data on the RMB is only available since the fourth quarter of 2016

FIGURE 5: PBC FOREIGN EXCHANGE RESERVES AND ESTIMATED MONTHLY CHINESE NET CAPITAL FLOWS



Source: Caribbean Development Bank, Bloomberg

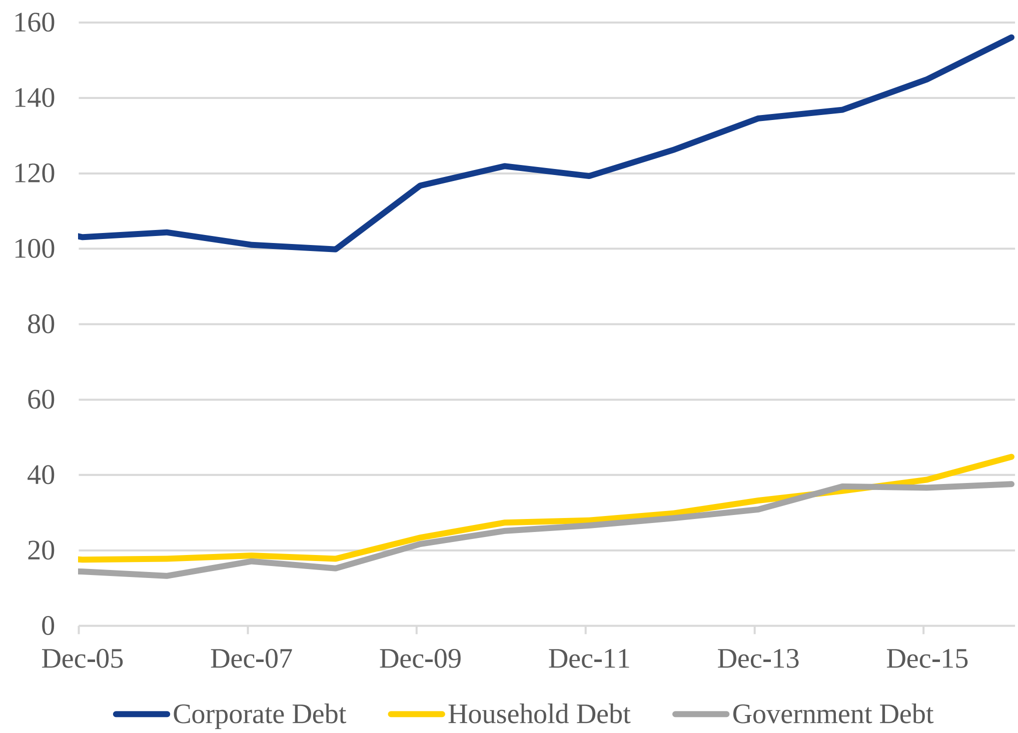
4.16 Lastly, systemic risk is also an important issue to keep in consideration. Important micro-prudential regulation needs to work in tandem with macro-prudential regulation, so as to keep individual banks sound, as well as contain the systemic risk of a collective failure that banks may be exposed to. A sharp movement in the price of RMB denominated assets may adversely affect many parties simultaneously, creating a situation where many banks become stressed and in risk of loss of solvency, due to high leveraging in the financial system. Additionally, financially sound banks may not be able to access credit due to high uncertainty surrounding exactly which banks are actually under pressure. This is a situation similar to that of the recent credit crunch during the US financial crisis. As such, the degree of leverage in the Chinese economy, which has risen fast over the last decade, especially regarding the corporate sector (please refer to Figure 6) is a worrying trend. The strong expansion of credit in the Chinese financial system over the last two decades, driven mainly by a strong accumulation of debt, both domestic and external, by the Chinese corporate sector, implies that the total level of leverage of the Chinese economy in relation to the Chinese GDP has already exceeded leverage levels in some industrialised nations. While leverage in the household and in the government sector remains very reasonable at 44.8% and 37.6% respectively, corporate sector leverage at 156.1% of GDP was very high at the end of 2016. The Bank for International Settlements reported Chinese corporate debt at 166.2% of GDP in September 2016, compared to Emerging Markets in general at 105.9% and the US at only 72.8%. Also, debt levels of the non-financial sector in general (including essentially non-financial corporates, the public sector, households and not-for-profit organisations) is very high in China at 210.6% of GDP in the fourth quarter of 2016, compared to 252.9% in the USA, 163.8% in the UK, 162.9% in the Eurozone and 158.0% in Japan[8]. The huge USD 1 trillion Belt and Road initiative, while being key for the improvement of infrastructure between China and Europe,

[8] FRED II database of the Federal Reserve Bank of St. Louis https://fred.stlouisfed.org/ .

could provide further prospects for RMB globalisation, but is as well expected to lead to a further thrust in debt levels in China and in its neighbouring countries, which will be closely followed by institutions doing business in RMB.

4.17 The increasing leverage in the Chinese economy has not gone unnoticed in the Chinese Interbank lending market, where the Shanghai Interbank Offered Rate (SHIBOR) for overnight funds has increased from 1.1% to 2.8%, and the one-month rate from 2.4% to 4.6% between May 2015 and June 2017, although the main policy interest rate of PBC, the two-year lending rate has been lowered from 5.35% to 4.35% in the meanwhile (please refer to Figure 7). The rise in SHIBOR rates against the backdrop of a falling policy rate expresses the financial community's worries about the health of the Chinese banking system.

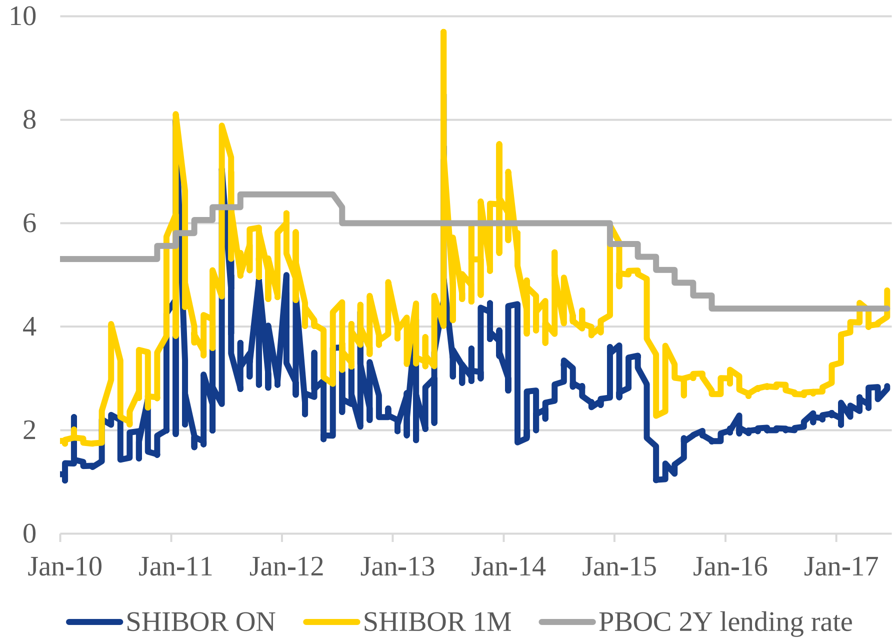
FIGURE 6: THE CHINESE ECONOMY'S DEBT RATIOS IN PERCENT OF GDP HAVE RISEN FAST SINCE 2005



Source: Caribbean Development Bank, Bloomberg

4.18 The relative decline in the usage of RMB for global payments since summer 2015, which was described above, suggests that businesses and financial institutions may have reacted to a slow-down in the Chinese economy, to reduced Chinese trade surpluses, to capital outflows from China and to a slight depreciation of RMB by reducing their China exposure. It is still expected that further Chinese engagement in the Region will lead to significant new opportunities for businesses, tourism and financial institutions, but it has become increasingly apparent that expectations regarding future macro-economic, financial and exchange rate developments on China have become more cautious over the last years and will also influence the degree to which RMB will be able to replace USD in the Region.

FIGURE 7: THE SHANGHAI INTERBANK OFFERED RATE (SHIBOR, IN PERCENT) IS INCREASING STRONGLY SINCE 2015 ALTHOUGH THE MAIN PBC TWO-YEAR LENDING RATE IS DECLINING



Source: Caribbean Development Bank, Bloomberg

SECTION 5

5. CONCLUSION AND POLICY ADVICE

5.1. In some respects, the speed of internationalisation of RMB has slowed over the last two years or so, as the share of the use of the currency in total global payments has declined. However, at the same time the clearing and settlement infrastructure has significantly improved with the introduction of CIPS and its connection to SWIFT. Also, PBC has increased the number of offshore RMB centres, which should further enhance the possibilities of BMCs to increase trade, tourism, investment and access to global financial services by increased use of RMB.

5.2. One caveat, however, is that BMCs will need to work harder to improve the business environment, to remove structural impediments and improve governance, as well as engage all relevant stakeholders in order to attract more FDI from China as well as reap potential benefits in a more efficient manner. Also, further efforts in enforcing AML/CFT standards are needed in order to ensure additional CBRs provided by Chinese banks are in keeping with international standards.

5.3. Importantly, regional authorities (governments, regulatory authorities and central banks) need to reflect on measures that could improve the integrity of the financial sector and increase access to financial services. Such reforms could include *inter alia* strengthening financial architecture and facilitating financial innovation, inclusive of the use of RMB. These measures should facilitate commercial banks' and their customers' access via RMB offshore centres and CIPS payment system.

5.4. In its policy paper on Latin America and the Caribbean, China has once more confirmed that it is prepared to engage further with the Caribbean, for the mutual benefit of China and the Caribbean. Past engagement has taken the form of aid, FDIs, trade, tourism and cultural exchanges. By the same token, regarding RMB, the creation of settlement facilities, swap agreements and investment facilities should bring further benefits for citizens and businesses in the Caribbean.

5.5. The overall international success of RMB and consequently also its degree of adoption in the Caribbean, will also depend on the progress China makes regarding the liberalization of its capital account and of its domestic financial markets. The full potential of RMB internationalisation can only be reaped if China's financial sector becomes more integrated with the world economy, as this would prevent the RMB market from remaining a fragmented one. This would ensure that investors, financial markets and trade participants are not plagued by liquidity risks. Currently, capital controls are inducing such risks rather than mitigating them.

5.6. Systemic risk is also a significant issue to be aware of, considering that deeper financial integration with the Chinese financial system via use of RMB and CBRs, would make BMCs more susceptible to shocks stemming from excessive levels of leverage in the Chinese economy. It is important that macro-prudential tools are used to maintain stability.

5.7. Eventually, it will be up to the business community to decide whether the RMB is to play a broader and more substantial role in CDB's BMCs.

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