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Financial Cooperation Between Japan and China Entering a New Phase

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Financial Cooperation Between Japan and China Entering a New Phase

On May 9, Chinese Premier Li Keqiang visited Japan and a Japan-China summit dialogue was held. In the statement after the dialogue, a positive agenda was revealed reflecting improving relations between Japan and China, such as in the RQFII program allocation of CNY 200 billion to Japan. This article will introduce the contents of the agenda and examine its impact on financial business in Japan.

Financial Cooperation Between Japan and China Entering a New Phase¹

Ken Muramatsu
Global Strategy Department,
Mizuho Securities Co., Ltd.

On May 9, 2018, China's Premier Li Keqiang came to Japan for a Japan-China summit dialogue with Japan's Prime Minister Shinzo Abe. Even though it is difficult to say that the relationship between Japan and China has been very good since 2012, this summit dialogue made it clear that the two countries are keen on prioritizing the alliance between Japan and China mainly in the economic sector, having seen the "America First" policy of U.S. President Donald Trump. This article will introduce the agreement reached at the above summit dialogue regarding the financial sector and investigate the impact of such agreement on financial business in Japan.

1. Financial cooperation between Japan and China

First, let's discuss the past situation. In December 2011, then-Prime Minister of Japan Yoshihiko Noda and then-Premier of China Wen Jiabao agreed on "Japan-China financial cooperation" at a summit dialogue between the two countries. Such "Japan-China financial cooperation" was defined to "promote financial transactions between the two countries by strengthening mutual cooperation in the financial markets in both countries in order to support the growing economic and financial relationship between Japan and China." This cooperation is thus considered to be a contributing factor for the stability of the financial system in East Asia, which is profoundly related to the international financial system, as well as to the Japanese economy, in particular.

The contents of the financial cooperation between Japan and China agreed to in 2011 include: (1) promotion of the use of the Japanese yen and the Chinese yuan in cross-border transactions between the two countries, (2) support for the development of a direct exchange market between the Japanese yen and the Chinese yuan, (3) support for the healthy growth of the Japanese yen-denominated and Chinese yuan-denominated bond markets, and (4) recommendation of the development of Japanese yen-denominated and Chinese yuan-denominated financial products and services in foreign markets led by the private sector. It was also agreed to establish a joint working group. In addition, there were specific goals stated in the agenda, such as: cross-holdings of government bonds between Japan and China,² issuance of panda bonds by the Japan Bank for International Cooperation, establishment of a Renminbi clearing bank in the Tokyo market, and the allocation of RQFII investment. The agreement aimed at an alliance in a wide range of fields related to financial markets, such as trade, foreign exchange, bond markets, and various financial products and services. It can thus be said that this agreement was an important initiative also from the point of view of financial and capital market business. It should also be mentioned that this agreement was an innovative initiative at that time regarding Japanese cooperation with China in the financial sector. For example, a direct exchange market was established for the first time between the Japanese yen and the Chinese yuan, and similar frameworks later spread to other countries in the world.

¹ For details about the system regarding investment in the bond market in Mainland China and about the history of deregulation, please refer to Mizuho Financial Group's *Chinese Bond Trading Business* (2017) published by Kinzai Institute for Financial Affairs, Inc.

² Currently, the Chinese government holds Japanese government bonds, but the Japanese government does not hold Chinese government bonds.

On the other hand, this financial cooperation between Japan and China did not see any remarkable development thereafter due to a change in the relationship between Japan and China, while many financial business initiatives are starting in many places around the world making use of the Chinese yuan, along with the internationalization of the Chinese yuan.

2. Japan-China summit dialogue: Regarding handling as related to the financial sector

Under such circumstances, during the APEC summit meeting held in 2014, Chinese President Xi Jinping and Japanese Prime Minister Shinzo Abe were able to hold a summit dialogue, while in the U.S., the new government under U.S. President Trump was being established, gradually raising the motivation to revise the alliance between Japan and China once again in both countries. In 2015, MUFG Bank (then The Bank of Tokyo-Mitsubishi UFJ, Ltd.) and Mizuho Bank issued bonds denominated in the Chinese yuan in the Tokyo market (Fujiyama bonds). Furthermore, in December 2017, the Ministry of Finance of China and the Financial Services Agency of Japan issued an “exchange of letters on cooperation in the area of audit oversight with the Ministry of Finance of the People’s Republic of China.” Consequently, in January this year, Mizuho Bank and MUFG Bank issued Panda bonds. There were thus a series of events symbolizing the developing relationship between Japan and China. Reflecting such a softening tension between the two countries, three positive goals as listed below were adopted in the agenda as an outcome of the Japan-China summit dialogue held this time.

Fig. 1: Agreement regarding the financial cooperation between Japan and China at the Japan-China summit dialogue

- 1. China will give Japan an allocation of the RQFII (Renminbi Qualified Foreign Institutional Investor) program worth CNY 200 billion (approximately JPY 3.4 trillion).
- 2. Both Japan and China will complete necessary work for the establishment of a Renminbi clearing bank and the conclusion of the Japanese yen-Chinese yuan currency swap agreement.
- 3. China will give Japanese financial institutions a bond transaction license at an early timing while efficiently

Source: Ministry of Finance

3. Evaluation of the matters agreed to this time and their impact on financial business

Subsequently, let’s evaluate the matters agreed to this time, along with their impact on financial business.

(1) RQFII program

First of all, let’s discuss the RQFII (Renminbi Qualified Foreign Institutional Investor) program. This program refers to a system in which each country and each investor receives an allocation for investment in the Chinese

capital market so that they can invest in Chinese yuan in said market. Previously, a QFII (Qualified Foreign Institutional Investor) system was used, in which investment was, in principle, limited to the U.S. dollar. However, as a result of the fact that the offshore Renminbi market expanded along with the internationalization of the Chinese yuan, the RQFII program was given to Hong Kong in 2011 to make it possible to invest in Mainland China using offshore Chinese yuan. Thereafter, the RQFII program was also provided to Taiwan and Singapore, which both have strong economic ties to China. After the visit of President Xi Jinping to Europe in 2014, the RQFII system was also expanded to various countries in Europe such as France and Germany, followed by provision to various countries and regions around the world.

Fig. 2: RQFII allocation

Target country or region	Allocation	Amount (RMB billion)
Hong Kong	Dec. 2011	500
Taiwan	Jul. 2013	100
Singapore	Jul. 2013	100
U.K.	Jul. 2013	80
France	Jun. 2014	80
South Korea	Jul. 2014	120
Germany	Jul. 2014	80
Qatar	Nov. 2014	30
Canada	Nov. 2014	50
Australia	Nov. 2014	50
Switzerland	Jan. 2015	50
Luxembourg	Apr. 2015	50
Chile	May 2015	50
Hungary	Jun. 2015	50
Malaysia	Nov. 2015	50
Thailand	Dec. 2015	50
UAE	Dec. 2015	50
U.S.	Jun. 2016	250
Ireland	Dec. 2016	50
Japan	May 2018	200

Source: Compiled by the author

The allocation of the RQFII program to the U.S. and Japan did not happen for a while due to diplomatic issues. However, with regard to the U.S., at the U.S.-China Strategic and Economic Dialogue held in 2016, the allocation of the RQFII program was agreed on. With regard to Japan, as was mentioned above, the allocation of the RQFII program was agreed at the Japan-China summit dialogue held this time.

The scale of allocation to Japan, CNY 200 billion, is the third largest in the world after Hong Kong and the U.S., which symbolizes the improving relationship between Japan and China. It is a great diplomatic achievement. On the other hand, while there was no RQFII allocation to Japan, the Shanghai-Hong Kong, Shenzhen-Hong Kong Stock Connect was established for the stock market, and the Bond Connect was also introduced last year for the bond market. Compared to 2012, the necessity for the RQFII program has thus been diminished, and therefore the allocation of the RQFII program to Japan is not necessarily expected to impact financial business. In the times ahead, investors operation based on index such as pension funds are likely to use the allocated RQFII program based on the fact that Chinese A-shares have been included in the MSCI Emerging Markets Index.

(2) Renminbi clearing bank and currency swaps

A Renminbi clearing bank is in charge of the general management of the Chinese yuan in the offshore market. As Chinese yuan transactions will be centralized, the efficiency of settlement and the safety level of transactions are expected to be enhanced. As is the case with the RQFII program, branches of major Chinese banks in many places around the world have been nominated as Renminbi clearing banks by the People's Bank of China (PBOC) and have been carrying out the designated operations.

Even though no specific plan was announced this time, there have been efforts to establish a Renminbi clearing bank in the Tokyo market, such as in the cooperative alliance between Bank of China and Japan Exchange Group. It is thus expected that a Renminbi clearing bank in the Tokyo market will be nominated at some point.

It should also be mentioned that one of the expected roles to be played by a Renminbi clearing bank is to supply liquidity when the amount of Chinese yuan becomes low in the Tokyo market. However, the activities to supply liquidity have not been unified among Renminbi clearing banks around the world, and given that there is usually a low amount of Chinese yuan in the Tokyo market, this role may not have significant impact.

On the other hand, the PBOC established the CIPS (RMB Cross-Border Interbank Payment System) in 2015, developing an infrastructure for cross-border Chinese yuan settlement. The CIPS is the Chinese equivalent of a CLS bank.³ It is therefore important to keep in mind that, in the future, the majority of cross-border Chinese yuan transactions are likely to be carried out through the CIPS.

A currency swap is a type of safety net between governments to prepare for situations such as currency crisis. It is therefore not expected to impact business in the private sector.

(3) Encouragement for Japanese financial institutions to engage in business involving Chinese securities

Recently, the Chinese monetary authorities announced significant deregulation regarding foreign securities companies entering China in terms of ratio of ownership and scope of business, etc. Previously, securities companies could only make minor investment, while there have already been local banks 100% financed by foreign banks. However, by 2020, it is expected that there will be securities companies 100% financed by foreign companies. In the Chinese financial system, universal banking is used for operations related to bonds, and securities companies therefore carry out their business mainly in the stock market. After the confusion in 2015, the stock market in China has needed further structural reforms. However, there is no doubt that there is great potential and various dynamics at play that can lead to many opportunities for new business.

Furthermore, under the financial system discussed above, in China, bonds are received and traded in the circulation

³ This is a bank established in New York mostly owned by major private banks from around the world in order to cut foreign exchange settlement risks. It deals with continuous linked settlement.

market mainly through banks, and licenses for such operations are gradually being granted to foreign financial institutions. So far, Japanese financial institutions were put in line behind European and U.S. financial institutions, due to political issues. However, based on the new agenda, it is expected that licenses will be given to Japanese financial institutions in an accelerated manner.

According to the statistics released by Asia Development Bank, the bond market in China has been growing rapidly to become the third-largest bond market in the world after the U.S. and Japan, with a balance issued at USD 8.7 trillion as of the end of 2017. It is possible that the size of the Chinese bond market will exceed the size of the Japanese bond market and that it will certainly be the main market in Asia. For Japanese banks that are reinforcing their business in Asia, China is an essential market to deal with.

We expect that the resuming financial cooperation between Japan and China will bring positive impact to financial business in Japan.

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