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Renminbi Internationalisation and US Dollar Hegemony

By Elgin Chan and Li Mingjiang

SYNOPSIS

China has made some progress over the last two decades to promote the internationalisation of the Chinese Renminbi (RMB). International sanctions on Russia for its invasion of Ukraine have been helpful to its efforts. But policies within China's own financial system will continue to constrain the RMB's global influence.

COMMENTARY

China's interest in internationalising its national currency, the RMB, has been a key element in its grand ambition to achieve greater economic and political influence on the world stage. The intensifying US-China strategic rivalry and the international sanctions imposed on Russia following Moscow's invasion of Ukraine have helped to increase the usage of RMB, while further strengthening Beijing's resolve to accelerate its internationalisation process. Over the last two decades, China has made fair progress in promoting its currency globally, but significant challenges remain.

China's Actions to Internationalise the RMB

Starting in 2009, Beijing initiated a pilot programme to boost the usage of RMB for international trade settlement and financial market transactions, by permitting companies in some Chinese cities to invoice and settle trades in the currency with counterparts from Hong Kong, Macau, and ASEAN countries. To support this trade settlement programme, Hong Kong was designated as the first site where banks were authorised to offer a range of RMB services to non-Chinese residents, including taking deposits, lending, and trading RMB in the offshore currency market (known as the CNH market).

These services, combined with the development of the Hong Kong CNH bond market, played a pivotal role in boosting RMB usage and liquidity abroad. Subsequently, several other offshore RMB bond markets were established in Frankfurt, London, Luxembourg, Paris, Singapore, Taipei, and Zurich.

In a move to liberalise its domestic financial markets, Beijing launched the Shanghai-Hong Kong Stock Connect in 2014, which permits foreign investors to trade shares listed in Shanghai via Hong Kong and vice versa. Similarly, Bond Connect, a counterpart to Stock Connect, was further developed in 2017 to enable foreign investors greater access to China's onshore bond market and vice versa, thereby increasing the volume of RMB denominated financial products transaction offshore.

To encourage the use of RMB internationally, Beijing signed the largest number of Central Bank Bilateral Swap Arrangements (BSA) of any nation globally with a potential US$500 billion equivalent of RMB liquidity on standby. These BSAs helped to address the shortage of RMB outside China, due to Beijing's own tight capital controls, by enabling foreign governments easier access to the currency for balance of payment financing, interest payments, loan payments and other payment obligations.

Beijing has also implemented a series of other policy initiatives in recent years, including:

(i) the introduction of gold and crude oil futures contracts denominated in RMB;

(ii) the use of RMB for financing and trade settlement with members in the Belt and Road Initiative (BRI); and

(iii) the utilisation of RMB as loans and bond issuance from the Asian Infrastructure Investment Bank (AIIB).

No "Big-Bang" but Steady Progress in the Expansion of RMB Usage

According to Society for Worldwide Interbank Financial Telecom (SWIFT), the RMB's share of global payments by early 2022 was still minimal at 3.2 per cent, compared with the USD at 39.92 per cent. Similarly, the RMB's share of global foreign exchange reserves was only 2.88 per cent compared with that of the USD at 59.53 per cent. Obviously, despite the above-mentioned Chinese policies, Beijing's efforts have not generated any dramatic change to the global financial structure.

This fact, however, should not obscure the steady increase in the RMB's use abroad over the past two decades. Data from the People's Bank of China (PBOC) show that in 2020, there were RMB28.39 trillion worth of cross-border receipts and payments settled in RMB, an increase of 44.3 per cent from 2019 and significantly from 2010. As indicated by SWIFT statistics in January 2022, the RMB was the fourth-most used currency for international payments. By the second quarter of 2022, the RMB's share of foreign exchange reserves was also ranked fifth with a share of 2.88 per cent, an increase of 1.78 per cent from 2016. Given that the RMB was hardly ever used as a reserve currency until 2015 and for international payments prior to 2008, these rankings are impressive.

Furthermore, China's ambition for the RMB to be included in the IMF's Special Drawing Right's (SDR) basket was realised in 2015 when the IMF Board agreed to include the currency in the SDR basket with a weight of 10.92 per cent. In May 2022, the IMF further raised the weight of the RMB to 12.28 per cent after its quinquennial review of the SDR, further underlining the importance of the RMB in the international monetary system.

Sanctions on Russia Help RMB Internationalisation

The sanctions imposed on Russia by the Western powers following its invasion of Ukraine, particularly on the economic front, freezing nearly half of Russia's foreign currency reserves, have severely crippled its economy. The Russian Ruble (RUB) lost almost 68 per cent of its value against the USD in the first couple of weeks of sanctions. Amid increased financial markets and exchange rate volatility, Russia was left vulnerable because of blockage of access to the SWIFT.

The US had essentially 'weaponised' the USD, exerting "currency statecraft" to punish Moscow for its invasion of Ukraine. This action inadvertently made the RMB a viable option as an international currency for states to diversify from the USD and the Euro (EUR), especially those that are not on friendly terms with the US.

Indeed, Moscow's exchange recently started to trade bonds where transactions would be settled in RMB. According to Russian media, state-owned oil company Rosneft issued RMB10 billion worth of bonds this September. This came after Polyus, the biggest gold producer in Russia, had raised RMB4.6 billion in a bond offering in late August.

Russia's leading business groups have also requested the central bank to increase its RMB reserves in an effort to stabilise the RUB. Not surprisingly, since half of its foreign reserves were frozen by the US and its allies, Russia has reportedly contemplated a foreign exchange reserve strategy of buying as much as US$70 billion in RMB and other "friendly currencies."

Observers believe that the sanctions on Russia may lead to a gradual dilution of the dominance of the USD and the emergence of a more fragmented international monetary system. During the 14th BRICS Summit in June, Russian President Vladimir Putin stated that the BRICS countries are "developing a new basket-based reserve currency," to circumvent the use of the USD, which will further allow the RMB greater usage and influence in international trade and investments. If this trend continues, it can create conditions that will facilitate greater adoption of RMB as an international currency.

RMB's Future Trajectory

In addition to the outcome of China's policies since 2009, and the effects of the sanctions on Russia following its invasion of Ukraine, the sheer size of China's economy may also render the RMB an attractive alternative to the USD. As the world's second-largest economy and commanding most of its trade, China should be able to provide vast transactional networks for the RMB to develop. Indeed, according to

Allianz Trade data, the percentage of Chinese trade settled in RMB increased from less than 20 per cent to almost 30 per cent between early 2020 and August 2022.

That said, China's hopes for the RMB will continue to be constrained by several structural factors, including especially its inability to significantly liberalise its financial markets, ease capital controls as well as allow for greater convertibility between RMB and foreign currencies. As a result, RMB's internationalization will continue to grow in an incremental manner, and USD hegemony – the dominance of the USD in the international monetary system – will continue for some time.

Elgin Chan is a PhD student at the S. Rajaratnam School of International Studies (RSIS), NTU, and Li Mingjiang is Associate Professor and Coordinator of the PhD Programme at the same school.
