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China's Renminbi Internationalization

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SYNOPSIS

China has achieved some success in its Renminbi (RMB) internationalization strategy over the last two decades. Recent international sanctions imposed on Russia for its invasion of Ukraine have fueled China's determination to expedite this strategy in order to protect Chinese national security and economic interests. While the United States has taken steps to counter China's RMB internationalization initiatives and to maintain the existing role of the US dollar (USD), a more intensive US-China competition in this arena is anticipated because RMB internationalization is closely linked to China's strategic priorities.

COMMENTARY

China's ambition to internationalize the RMB is part of an effort to secure its national security and economic interests. To safeguard itself in the event of Western sanctions, China would need to insulate itself from its reliance on the USD by pursuing greater RMB internationalization. Not surprisingly, President Xi Jinping encouraged the Arab states of the Gulf Cooperation Council (GCC) to use the RMB for the settlement of bilateral oil and gas transactions during their summit in Riyadh on 9 December. This seems part of China's strategic game plan.

Forces Driving RMB Internationalization

Beijing's RMB internationalization strategy dates back to 2009, at the height of the global financial crisis at that time, when Zhou Xiaochuan, then-Governor of the People's Bank of China (PBOC), published a paper expressing concerns about the global reserve system being based on the "fiat" USD. The key concern for Beijing then was the significant economic loss to China, which was and still is one of the largest holders of the USD, if the currency were to depreciate in a disorderly fashion due to monetary and fiscal stimulus in the industrialised countries.

More recently, these concerns have increased and widened to include geoeconomic and geopolitical tensions – the Taiwan issue, South China Sea disputes, US-China trade war, and semiconductor decoupling – between the No. 1 and No. 2 economies in the world today. In these circumstances, China's reliance on the USD for everything from trade payments, foreign direct investments (FDI), and energy imports transactions, has rendered its national security and economic interests vulnerable. In fact, China, the world's leading oil importer, imported 72 per cent of its needs in 2021 and made the majority of the payments in USD.

The West's sanctions against Russia following the latter's invasion of Ukraine have been a tocsin for China given its substantial reliance on and high investment concentration in the USD. The removal of Russia from the Society for Worldwide Interbank Financial Communications (SWIFT) system and the freezing of nearly half of its US$630 billion foreign reserves had caused the Russian Ruble (RUB) to lose almost 68 per cent of its value against the USD in the first couple of weeks of sanctions, bringing economic hardship to that country. Although Russia's central bank was able to stem the decline of the RUB, the Russian economy is projected to shrink 2.5 per cent in 2023, following a 3 per cent contraction in 2022.

China currently holds US$970 billion in US treasuries and securities, which is almost one-third of Beijing's total foreign reserves. Hence, in the event of a military conflict, Beijing will not only have to weigh the ramifications of a US military response, but also US-led sanctions that will cripple China's economy.

Promoting RMB to Safeguard China's National Security Priorities

China's spectacular economic growth has increased its ability to protect its security and economic interests. There are three issues over which China might find itself embroiled in a war. These are a declaration of independence by Taiwan, the Sino-Indian border dispute, and overlapping claims in the South China Sea.

Beijing is undoubtedly taking note of the deleterious effects of Western sanctions on the Russian economy. To counter the possibility of Western sanctions in a conflict, Beijing will need to insulate its economy from its reliance on the USD. It will need to promote greater RMB internationalization to protect Chinese economic and security interests.

Current RMB Internationalization Initiatives

China has been striving to elevate the RMB's role in the international monetary system. Beijing has undertaken more concerted steps over the past decade to minimize its reliance on the USD while increasing the use of the RMB in commercial operations, which saw RMB-denominated trade settlements increased from a negligible amount in 2009 to more than RMB6.77 trillion, that is exceeding US$1 trillion in 2020.

To induce greater use of the RMB for trade and investments, Beijing has established: (i) numerous offshore RMB hubs in important financial centres like Doha, Frankfurt, London, Paris, Singapore and Zurich; (ii) central bank bilateral swap agreements with 41 countries, with a potential RMB3.5 trillion (US$554 billion) equivalent of RMB liquidity; and (iii) the Shanghai-Hong Kong Stock Connect and Bond Connect to enable foreign investors greater access to China's onshore capital markets and vice versa.

China launched the Belt and Road Initiative (BRI) in 2013 to project its influence and to increase the RMB's international usage. Presently, the BRI involves 149 member countries worldwide. According to PBOC statistics, China's RMB settlements with BRI participants reached RMB5.42 trillion (US$763.4 billion) in 2021, representing a 19.6 per cent increase year on year. Aiming to raise RMB prominence in the energy trade at the recent China-GCC Summit, President Xi suggested that China and the Gulf nations should make full use of the Shanghai Petroleum and National Gas Exchange as a platform for RMB settlement of oil and gas deals.

Outlook on Future RMB Internationalization

According to SWIFT data, the RMB was the fourth most-used currency for international payments in January 2022. This is noteworthy given that the RMB was rarely used as a reserve currency until 2015 and for international payments prior to 2008. Although the use of RMB is still low compared with the USD and Euro, China is determined to expand the RMB's usage globally in the foreseeable future.

Undoubtedly, China's internationalization of the RMB is closely linked with its economic and security priorities. Looking ahead, China will target small and middle powers that are likewise seeking to reduce their reliance on the USD through the diversification of their foreign exchange reserves. Developing countries in the Middle East, Africa, Latin America, and Southeast Asia will become the focus of China in its RMB internationalization ambitions, since they are more receptive to having closer economic ties with China. Indeed, in recent years, a number of developing nations like Angola, Brazil, Cambodia, Iran, Laos, Qatar, United Arab Emirates, Venezuela, and Zimbabwe have been accepting the RMB as one of the main international currencies for commercial exchange, unit account, and store of value.

As China reopens its economy to live with the COVID-19 pandemic, and as its economy gradually recovers, Beijing is likely to exert greater efforts to challenge the USD-denominated global trade and finance system through RMB internationalization. While Beijing's initiatives will take time and face formidable obstacles, they will ultimately benefit China across the economic and security spectrums.

To counter the rise of China and the internationalization of the RMB, the US has taken concerted steps to develop stronger ties with the Middle East, Africa, and the Indo-Pacific. These include President Joe Biden's recent visit to Saudi Arabia (July 2022), convening of the US-Africa Leaders Summit in Washington (13-15 December 2022), and the launch of the Indo-Pacific Economic Framework for Prosperity (IPEF) on 23 May 2022.

Competition in the currency realm, where China seeks to challenge the US-led status quo, will become increasingly fierce as both countries make the developing world a crucial battleground for influence. It is therefore necessary to pay more policy attention to what China and the US will do going forward as stability in financial and international markets is essential for sustaining economic recovery after the devastating impact of the COVID-19 pandemic.

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