The Internationalization of the Chinese Renminbi: Firm Steps, But a Long Road Ahead

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The whole world is observing the economic ascension of China. Recently, it became the largest manufactory producer in the world, the largest global economy by purchasing power parity, and a leader in technology development in several fields. As a consequence, we often listen to prognostics that this country will soon become the new hegemon of the globe. Nevertheless, many analyses ignore (or undervalue) the observation of a crucial dimension of this process: the monetary one. An attentive scan of history shows clearly that money is power. The so-called Pax Britannica was strongly (although not exclusively) based on the centrality of the sterling pound for the world economy, which prolonged the international ascendancy of the United Kingdom, even when the United States (USA) was already the world's most important manufacturing economy. Later on, it was not by chance that in the Bretton Woods Conference (1944) the USA so inflexibly imposed the US dollar as the new key-currency of the International Monetary System (IMS) that emerged after the World Wars. The design of the IMS has evolved since then – from a dollar backed by gold to a fiduciary dollar since 1971 – but the USA has kept its effort to maintain the dollar as the key currency of the world.

The benefits arising from the possibility for a country to issue the key-currency of the world economy are very profound and diverse, having been appropriately named by Valéry Giscard D'Éstaing (French Ministry of Finance in the 1960s) as an "exorbitant privilege". First of all, this country has virtually no risk of running into a balance of payment crises. Secondly, changes in its exchange rates are almost innocuous, because most of the international trade prices are denominated in this currency. Following the two previous benefits, it has an almost illimited autonomy for its economic policy.

The Chinese government is certainly aware of these benefits, as well as of the problems related to the "dollar trap" – that is, a high dependency on the US dollar, as discussed by Prasad (2014) – in which the whole world (including China) is currently bind. Not surprisingly, it is deeply engaged in the effort to internationalize its national currency, the Renminbi (RMB).

The first steps of this effort can be traced back to the beginning of the 21st century, but it gained momentum with the outbreak of the global financial crises in 2008. Very indirectly, but meaningfully, the Governor of the People's Bank of China, Zhou Xiaochuan, declared in March 2009 that:

The outbreak of the current crisis and its spillover in the world have confronted us with a long-existing but still unanswered question, i.e., **what kind of international reserve currency do we need to secure global financial stability and facilitate world economic growth**, which was one of the purposes for establishing the IMF? (Zhou, 2009, p.1, my highlights).

Even if the US dollar is not mentioned, it is clear that proposing a reform of the IMS means questioning the supremacy of the US currency.

Besides the discourse, several initiatives were implemented and/or deepened since then. The most important was the inauguration of several offshore centers for transactions with the Chinese RMB. The first centers inaugurated, part of a pilot project, were previous to the crises (Hong Kong, the first and still the most important one was established in 2003). Since 2012, twenty-two new centers were inaugurated worldwide. The location of these centers reveals careful attention for regional distribution, with centers in Asia, Oceania, Africa, Western and Eastern Europe, North and South America. These centers are allowed to develop operations in RMB through authorized banks, which in almost all cases are Chinese. This is significant because the internationalization of a currency may be fostered by the internationalization of the national banking system and in the Chinese case both are being made simultaneously.

Another important measure was implemented in the aftermath of Zhou's abovementioned declaration in 2009, consisting of a pilot project for the denomination and settlement of international trade in RMB. After the first phase of tests, all barriers for the usage of RMB in foreign trade were eliminated in 2012. In parallel, bilateral agreements have been signed with several countries (notably in Asia) to stimulate trade in the local currencies, circumventing the necessity of using the US dollar.

Meanwhile, another pilot project was launched in 2011, for the settlement of Foreign Direct Investment in RMB. Gradually, but unquestionably, the Chinese government was amplifying the range of international operations allowed to be settled in its national currency. In addition, many swap agreements were implemented by China, creating a direct channel for the provision of liquidity in RMB for countries in need.

Yet, the Chinese monetary authorities are aware of the risks involved in making these moves without changing the platforms in which the operations are done – the recent sanctions imposed by the USA over Russia and Iran are very eloquent in showing that. Hence, CIPS (Cross-Border Interbank Payment System) was launched in 2015, with the explicit aim of facilitating cross-border RMB business and creating an alternative to the widely used – and Western-controlled – SWIFT.

Another critical maneuver is not a Chinese novelty and consists of the joint initiatives for the denomination of oil barrels prices in RMB. Historically, the US government has strongly impelled the denomination of energy commodities in dollar. This analogous Chinese move will certainly provoke significant geopolitical agitations ahead.

Finally, it is also worth mentioning an initiative with no operational consequences, but which is non-negligible in symbolical terms. China is using advertising campaigns in strategic spots worldwide (e.g. international airports in Europe and the USA) stimulating foreigners to invest in RMB (the "world currency", the "new choice").

It is therefore quite clear that the Chinese government is deeply engaged in the effort of internationalizing its currency. Naturally, these actions may be conjugated with other policies related to the external front. As mentioned above, it comes hand in hand with the process of internationalization of the Chinese banking system. Similarly, it may strongly benefit from the process of internationalization of Chinese companies, since they are spontaneously more prone to use the RMB both for trade and investments. Additionally, the Belt and Road Initiative (BRI) is potentially a far-reaching vector for increasing the international usage of the RMB – Chinese banks provide credit for investments in countries involved in the Initiative that may be used to hire companies and/or buy goods in China. These credit lines can be (at least partially) provided in RMB. Last but not least, China is a major player in new multilateral banks – namely, the New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB) – which may also provide credit lines in RMB.

The natural question that follows is: what are the outcomes of this effort regarding the RMB internationalization? Since there is no database organizing the usage of national currencies at the international level, a proper answer to the question above requires the analysis of some selected data from diverse sources to check how the international usage of the RMB is evolving over time.

The Bank for International Settlements (BIS) issues a Triennial Survey on the Global Foreign Exchange Markets that shows that the dominance of the US dollar is still unquestionable since 88.3% of all operations in these markets still use this currency (data for April 2019). As for the RMB, its usage is still very modest (4.3% of the total), but the evolution over time is remarkable: it was virtually zero in 2001 and less than 1.0% in 2010.

When it comes to the settlement of international trade, this evolution over the recent period is more impressive: Chinese foreign trade in RMB was null in 2009 and ten years later it represents roughly 15% of the total. Curiously, Chinese imports in RMB have been higher than exports in the recent period, and if the Chinese trade account in RMB is negative it results in the creation of liquidity in RMB overseas, which is crucial for the internationalization of a currency (Van Noije, De Conti and Zucker, forthcoming). As for the total of global trade settlements, the use of the RMB is still marginal (2.05%), but the importance of China for world trade may be certainly an impulse to increase this share in the near future.

As for the Chinese Foreign Direct Investments (FDI), a very surprising picture emerges: 91% of the total flows were settled in RMB in 2018 (PBOC, 2018). Nevertheless, this data has to be analyzed with caution because China massively uses the expedient of "triangular" overseas investments, meaning that the investments do not flow directly from China to the recipient country, but they make a "stopover" in any financial offshore center. What happens therefore is that these FDIs flow from China in RMB, but most of it is exchanged in one of the RMB offshore centers (generally Hong Kong) and then flows to the recipient countries generally in US dollars (or euros). Anyway, the intensification of this circuit undeniably helps to foster the international usage of the RMB.

Finally, it is necessary to analyze the usage of RMB as a reserve currency. In 2016, the International Monetary Fund (IMF) included the RMB in the basket of currencies composing the Special Drawing Rights (SDR) – along with the US dollar, the euro, the sterling pound, and the yen. Since then, COFER/IMF provides data for the participation of the RMB in the foreign exchange reserves, and this share evolved from 1.1% of the total allocated reserves in Q4.2016 to 2.0% in Q2.2020. It is still a very marginal share, but it is already higher than the ones related to the Australian dollar, the Canadian dollar, and the Swiss Franc.

It is thus clear that the international usage of the RMB is still not widely disseminated, but its evolution over the recent period is remarkable. This evolution was not linear because of financial stress in China in 2015-16 associated with a devaluation of the RMB that refrained the process, but the general outcome since the deepening of the related policies (in 2009) is unquestionably a considerable augmentation in the use of RMB overseas. In spite of this unequivocal increase, the international use of the RMB is still heterogeneous in terms of regions and monetary functions.

Concerning regional perspective, the use of RMB still depends on the geographical proximity to China, but mainly on the economic and geopolitical power of these countries in the world economy. In general terms, peripheral countries in Asia and Africa are more open to the use of the RMB – along with countries that share the will of changing the international order like Russia – whilst core countries are still reluctant to it. This constatation shows that even if China is already one of the major players in the world economy, it is still not able to impose the use of its currency on economic relations with core countries.

As for the monetary functions, we realize that the RMB is more used at the international level as a means of payment and unit of account. For reserve of value, the US dollar is still – and by far – the global currency. In other words, the US dollar keeps its role as the anchor for financial wealth, the safe haven against the uncertainties of the world economy. Considering that this monetary function is prominent in a financialized economy, we conclude that in spite of the ascension of the RMB, the status of the US dollar as the key currency of the world is still undisturbed.

The dimensions of the Chinese economy and the geopolitical power currently attained by the country definitely enable the internationalization of its currency. Nevertheless, for the RMB to eventually become an important reserve-currency additional steps are needed involving further deregulation of the Chinese financial account (which may be contradictory to some objectives of the country's development model), and further development of its capital market. In concrete terms, Chinese assets in general, but more specifically Chinese public bonds, have to become reliable receptacles for the global financial wealth. This requires appropriated policies, but also non-trivial changes in the conventions ruling the world financial community.

Summing up, it seems undoubtful that the RMB is progressively becoming an important international currency, but it does not mean that it will replace the US dollar as the key currency of the world economy in the near future. Anyhow, if Western analysts are waiting for a 'decisive clash of forces', Kissinger (2011, p. 23) reminds us that the Chinese method involves rather a 'patient accumulation of relative advantage', indicating that the crusades related to the future of the International Monetary System – sometimes eclipsed by the loud commercial and technological wars – will last, demanding the attention of all analysts focused on international relations.

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