

# Internationalization of the Renminbi in the Decoupling Era



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The internationalization of the Renminbi (RMB) has been a strategic goal for China for the last two decades. It refers to the process of increasing the global use and acceptance of the RMB as a widely recognized currency for trade, investment and reserve purposes. Since 2009, China has made institutional efforts to enhance the global role of the RMB - expanding the infrastructure for cross-border use of the RMB, including signing bilateral currency swap agreements with the major trading partners, establishing RMB clearing banks, and the RMB cross-border interbank payment system. Moreover, China has also significantly expanded trade, direct investment, and cross-border financing with countries participating in the Belt and Road Initiative. While there have been notable achievements, such as the inclusion of the RMB in the International Monetary Fund's Special Drawing Rights (SDR) basket in 2016, the global use of the RMB has been relatively limited, and the process of RMB internationalization has been stagnated.

Recently, however, the progress of RMB internationalization has been in the spotlight. The Renminbi Globalization Index, published by Standard

Chartered, serves as an indicator of the progress of RMB internationalization. The significant rise of the index in 2022, reaching its historical high (3,452) in October 2022, indicates the growing global demand and use of the RMB in trade and financial transactions. Indeed, the escalation of geopolitical tensions and the desire to reduce dependence on the US dollar have indeed contributed to increased global demand for the RMB as an alternative currency. In response to Russia's invasion of Ukraine, the United States and its allies have imposed sanctions on Russia, including removing its banks and firms from the Society for Worldwide Interbank Financial Telecommunications (SWIFT) system and freezing nearly half of its 630 billion USD in foreign exchange reserves. Consequently, the RMB has become more widely used to settle trade between China and Russia. For example, Gazprom, a Russian state-owned gas company, accepted half of its transactions with Chinese companies in RMB in September 2022. The Arab states and several emerging economies have been actively discussing the use of the RMB for bilateral trade and financial transactions with China.

China has made significant progress in increasing the international influence of the RMB as a bilateral trade settlement currency. However, experts generally agree that China still has a long way to go before it can fully internationalize its currency and challenge the dominance of the US dollar in the international financial market. According to SWIFT, the RMB's share of global payments, has remained relatively unchanged in recent years, at just 2.3 per cent. However, there has been a substantial increase in the RMB's share of trade finance has increased significantly, rising to 4.7 percent in May 2023 from 1.7 percent two years earlier. To achieve full internationalization, China would need to make significant changes to its economy, which will take time and carry risks. These include further capital account liberalization, the development of a market-based financial infrastructure, and the maintenance of a current account deficit that allows other countries to accumulate RMB-denominated claims on China.

So far, the geopolitical tensions seem to have helped RMB internationalization to some extent. With the progress of RMB internationalization, China may be able to exert more influence over its trading partners and mitigate the risks of potential sanctions due to the US dollar's dominance at the margin. However, the progress of RMB internationalization driven by geopolitical tensions and other exogenous factors could be limited in the following ways. First of all, China has focused on bilateral use of the RMB rather than true internationalization. True internationalization would involve broader acceptance of the RMB across multiple economies and regions. China has tried to maintain financial and exchange rate stability through capital control measures. This will become more difficult to manage once its currency is internationalized as the Chinese assets are stored and traded more offshore. Second, the use of RMB for trade

settlements among emerging and developing economies reflects their dependence on trade with China and concerns about potential sanctions under the dominance of the US dollar. However, major advanced economies, which account for the largest trade shares of China, may be less inclined to participate in RMB settlement due to concerns about China's intentions and potential implications for their own financial systems. Third, China has benefited from its trade being conducted in a reliable, dollar-based international financial system, which has contributed to its economic growth and the accumulation of its foreign assets. From China's perspective, it may be difficult to find an alternative to shifting its foreign assets that were already invested in the US dollar, including 3.2 trillion USD of foreign exchange reserves in April 2023, of which 59 percent was US dollar assets in 2016 (the latest data from China's State Administration of Foreign Exchange).

All in all, the current level of RMB internationalization has primarily remained in bilateral trade. It is far from replacing the US dollar globally, even if it is starting to replace the US dollar in some of China's trade relationships. China needs to overcome many internal and external challenges to fully internationalize its currency and potentially compete with the US dollar. It is not a silver bullet but a long-term process that requires careful and sustained management. **KIEP**