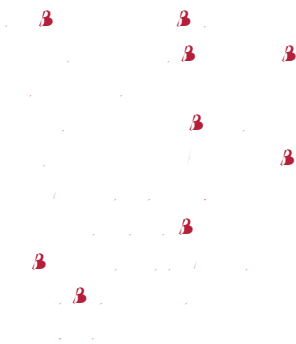

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Executive Summary

WESTERN CONCERNS THAT the renminbi could rival the dollar as an international currency contrast with underwhelming numbers in terms of global settlements in renminbi and with the experience of China's two main previous failed attempts to achieve renminbi internationalisation. However, China is moving towards a more realistic plan for renminbi internationalisation, focusing on China's strengths in trade and financing. China is now the main trading partner for a very large number of countries and has become a major creditor for a good part of the Global South. This, together with the increasingly frequent restrictions on the use of the dollar, is strengthening the renminbi.

THE CROSS-BORDER USE of the renminbi for trade settlements and financing (Chinese banks' overseas loans denominated in renminbi and official renminbi swap lines offered by the People's Bank of China) has been on the rise since 2022, coinciding with Russia's invasion of Ukraine and the relative decline of the dollar's share of global foreign reserves and the share of Chinese onshore assets held by foreign investors.

THE CURRENT PUSH is so far proving successful compared to previous attempts, but it remains hard to tell if China will succeed in this renewed attempt to internationalise its

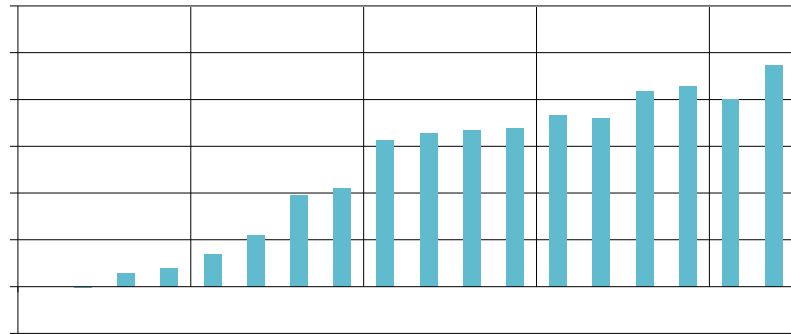
China is an economic giant not only in terms of manufacturing and exports, but also in terms of the size of its financial sector. China's financial sector is now the largest in the world, with \$60 trillion in assets, equating to 340 percent of China's GDP. Chinese banks also top the list of the largest globally systemic financial institutions, with increasing interrelationships with the rest of the global financial system¹. However, China's currency, the renminbi is little used internationally, at least when compared with the size of China's economy and financial sector.

There are three main reasons for this. First and foremost, the renminbi is not fully convertible, which means it cannot move freely in and out of China. Second, the legal framework surrounding renminbi payments is uncertain. In particular, investors continue to lack confidence about the rule of law in China. Third, China's financial markets, especially the Treasury market, are less liquid than US markets, and there is no expectation that this will change any time soon (García-Herrero, 2021).

According to the financial messaging provider Swift, the share of renminbi payments in total cross-border transactions increased somewhat during the first half of 2023, but remains

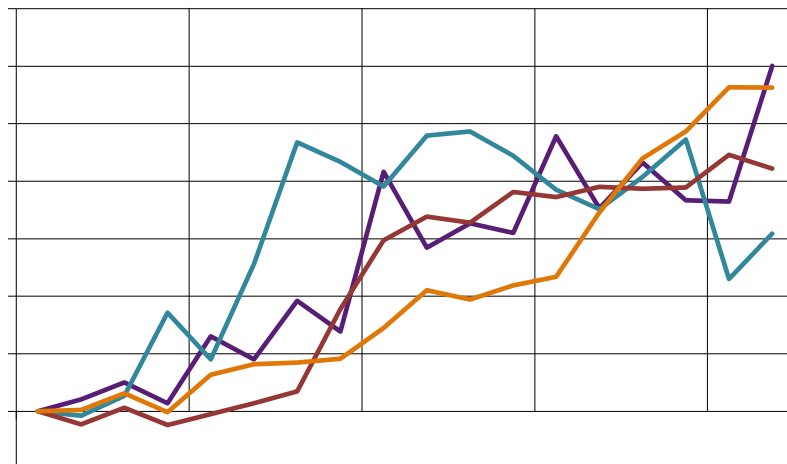
Even during the much tougher period from early 2022, as the Omicron variant reached China and zero-COVID-19 policies ravaged its economy, renminbi internationalisation continued, though at a much more moderate pace, even receding in the first quarter of 2023 as China opened up after the pandemic. In the second quarter of 2023, though, international use of the renminbi increased rapidly. The increase in the international use of the renminbi was quite balanced across the three functions captured by the index – payments, investment and funding – until recently. Since the end of 2022, investors seem to have lost interest in investing in renminbi, while use in trade and financing remains strong (Figure 3).

Figure 2: International use of the renminbi (Index, 2019=100)



Source: Natixis. Note: The index is composed of different indicators of cross-border use of the renminbi, including payments, investment and funding (see the appendix). Payments relates to trade settlements, and investment refers to demand for renminbi assets from foreign investors (whether private or public, such as central banks). Financing, from the host perspective, is borrowing in renminbi from private markets (loans from Chinese banks or issuing of renminbi-denominated bonds). Borrowing can also come from the People's Bank of China, though a growing number of swap-lines; this is classified as official borrowing.

Figure 3: International use of the renminbi (Index, 2019=100)



Source: Natixis.

To gauge the different speeds at which the renminbi is internationalising across the different uses of an international currency, we conducted an empirical analysis of the determinants of the cross-border use of the renminbi (Amighini et al., 2023). The results show that economic factors are certainly relevant in explaining the increasing cross-border use of the renminbi, but these are not alone in driving the international demand for renminbi.

Trade and financial linkages with China are the main drivers of cross-border renminbi payments, but only for countries that participate in China's Belt and Road Initiative (BRI). In particular, alongside trade transactions, receiving loans from China is found to explain



Figure 4: CNH Deposits in Hong Kong (in trillion renminbi)

Source: Bruegel based on PBoC, HKMA, CEIC, Natixis. Data as of August 2023.

While CNH deposits kept on growing, peaking at 1 trillion renminbi (\$145 billion) in December 2014, it became clear that it would be much harder to develop a set of CNH assets, whether loans or bonds. For the latter, a new market for renminbi-denominated bonds was created in Hong Kong, on which foreign companies or sovereigns could issue debt. This market, called the dim-sum bond market, has remained underdeveloped until recently (Figure 5). The loan market denominated in renminbi, meanwhile, has never really taken off.

Since then, the attempts to promote the international use of the renminbi have changed in nature. The next step was much more official: the entry of the renminbi into the International

The digital renminbi has been designed, first, to replace the limited physical cash that remains in circulation within the Chinese mainland's borders. But memorandums of understanding have been signed with several central banks, including the Hong Kong Monetary Authority (HKMA), the Bank of Japan and the Central Bank of the United Arab Emirates, to foster the cross-border use of the digital renminbi in these jurisdictions. In addition, a joint venture has been set up with Swift, which indicates China's aspiration of facilitating the global use of its new digital currency and, possibly, for the renminbi to become a reserve currency one day. Finally, the rapidly increasing use of China's international payment system (Figure 9), especially since Russia's invasion of Ukraine in February 2022, is also helping support the cross-border use of the renminbi.

Figure 9: Cross-border use of the digital renminbi

Source: Bruegel based on People's Bank of China, Wind; data as of Q2 2023.

The cross-border use of the digital renminbi suffered a setback from the collapse in movement of people across borders because of the COVID-19 pandemic. In particular, the massive

Figure 12: CO₂ emissions from coal, oil and gas (2014-2016)

Year	Coal	Oil	Gas
2014			
2015			
2016			

Source: IMF COFER. Data as of June 2023.

Figure 13: Oil price differential between WTI and Shanghai INE



Source: Bruegel based on INE, ICE, NYMEX. Note: Shanghai INE is the Shanghai International Energy Exchange. WTI is West Texas Intermediate, the North American benchmark.



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Theme	Measure	Function			Coverage		
		Medium of exchange	Unit of account	Store of value	Standard of deferred payment	Cross-border	On shore
Payments	RMB % of Swift international payments						
	RMB % of China's cross-border transactions via bank						
Investment	Foreign holding % of RMB financial assets						
	RMB % of global interest rate derivatives transactions						
Public financing	RMB % of global allocated reserves						
	Activated balance % of total BSLs						