Research On RMB Internationalization Under the International Monetary System

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Abstract. The existing system of international monetary is still highly influenced by the US dollar. As the main settlement currency for international trade and foreign exchange reserve assets of various countries, the US dollar has a profound impact on the global economy. However, with the US treasury bond reaching a historical high and its holders continuously reducing their holdings, many countries began to explore the construction of a non-US dollar settlement system. In this context, although the RMB internationalization process is in its infancy, it has shown great potential. This article adopts the method of literature review to study the current situation and RMB internationalization development path and explores the process and strategies of RMB internationalization under the current international monetary system. The RMB has made a progress in four areas: international settlement, international reserves, valuation functions, and infrastructure. “The belt and road” initiative provide an opportunity to strengthen the construction of the RMB cross-border financial market and to broaden investment channels for countries holding RMB.To further promote the internationalization of the RMB, it is necessary to deepen the binding between the RMB and the energy commodity market.Only after the RMB has completed functions of settlement and investment, do other countries have a sufficient willingness to hold RMB as foreign exchange reserves.

Keywords: RMB internationalization; currency function; trade settlement.

1. Introduction

Since the establishment of the Bretton Woods system in 1944, the dollar has been pegged to gold and established as the core status of the world's currency. Even after the disintegration of the system, the dollar has maintained its role as the dominant global currency by virtue of the economic and military strength of the United States and the international geopolitical layout behind it. The current international monetary system is a continuation of the Bretton Woods system. Among them, the US dollar is the main currency, the euro is the important currency, the RMB, the British pound, the Japanese yen and so on are the constituent currencies. The petrodollar, the strong military strength of the United States, the highly developed financial market of the United States and the advanced scientific and technological level of the United States are the four foundations of the dollar as the world's dominant currency. However, in the past half century, the spillover of the US monetary policy has caused varying degrees of impact on the economies of various countries in the world, causing people to think deeply about the perfection of the future international monetary system. At present, the level of US national debt has reached a historical peak, and the pressure of government debt repayment has increased, which has affected the international recognition of the US dollar to a certain extent. The world is standing at the crossroads of history and facing unprecedented changes in a century.

It has been 15 years since the internationalization of RMB started, especially the proposal of the Belt and Road Initiative, which has deepened the influence of RMB in countries along the route, and the international recognition of RMB is constantly improving. By adopting RMB in commodity trade with countries along the Belt and Road, and increasing the proportion of RMB in their foreign exchange reserves, the international recognition of RMB has been increasing. Two necessary stages in the RMB internationalization process. First, China's financial market can attract foreign investors to put their reserves of RMB assets into China's financial market. Second, China has enough attractive goods for foreign buyers to buy and settle in renminbi.

The internationalization of RMB has a profound impact on the current international monetary system. It is of great research significance and practical significance to explore such issues as whether the spillover of the US dollar policy can reduce the adverse impact on other countries in the world, whether the US dollar will still be the dominant currency in the future world trade, and how the internationalization of RMB will be carried out. This paper aims to study the current situation and development path of RMB internationalization, and discuss the process and strategy of RMB internationalization in the existing international monetary system.

2. The Current International Monetary System

2.1. Jamaica System

Looking back at the international monetary system, it has undergone several major adjustments over the past 80 years. Before 1944, the international monetary system was based on the international gold standard, where each country's currency had a fixed gold content. After the Bretton Woods Conference in 1944, the international monetary system shifted from the gold standard to a dual pegged system based on gold and with the US dollar as the main international reserve currency. However, in 1971, US President Nixon announced the decoupling of gold from the US dollar. In 1976, the Jamaican system was established and has been continuously revised and implemented to this day. The current international monetary system is a unipolar system dominated by the US dollar and based on credit anchors, with the US dollar serving as the primary settlement, valuation, and reserve currency globally [1].

2.2. US Dollar

After the Bretton Woods system collapsed, the US dollar was deeply tied to oil trading by reaching an agreement with the OPEC to bind the currency for oil trade settlement to the US dollar.Under the Jamaican system,the US dollar is the main foreign exchange reserve asset for international trade and the settlement currency for commodity markets in various countries. In addition, the anchor free printing of US dollars allows the United States to "collect" seigniorage taxes from countries around the world.And by now the size of US debt has reached $35 trillion.

In recent decades, the United States exported dollars through a current account deficit. By adjusting the federal funds rate through the Federal Reserve, a tide of dollars is formed. When the federal funds rate falls, the liquidity of the US dollar is released, and a large amount of dollars flows to countries around the world to purchase high-quality assets. When the federal funds rate rises, dollars from all over the world returned to the United States, accompanied by the bursting of economic foam in other countries. The adjustment of US monetary policy not only addresses domestic issues but also has a wide-ranging impact on the outside world, known as the spillover effect of US dollar monetary policy. In addition, financial institutions in US also utilize the tidal effect of the US dollar to harvest high-quality assets from other countries amidst fluctuations in the Federal Reserve funds rate.

2.3. De-dollarization and Reduction of Holdings in US Treasury Bonds

The spillover effects of US monetary policy directly affect global capital markets and the functioning of the world economy. To get rid of this "currency hijacking", some countries have begun to try to bypass the US dollar and strive to establish their currency settlement system [2]. In recent years, the Federal Reserve has cut interest rates and released dollars due to the economic recession caused by COVID-19 and then raised interest rates due to domestic inflation in the United States in 2022.

The tide of the US dollar has once again caused a decline in asset prices and economic recession in many countries. Through these experiences, countries around the world are also considering how to reduce the impact of the US dollar on their domestic markets. With the US treasury bond reaching a historical high, the largest holders of US treasury bond, such as China and Japan, began to reduce their holdings of US treasury bond.

3. Current Situation of RMB Internationalization

The internationalization of the RMB was proposed in 2009.Subsequently, the Chinese yuan officially joined the Special Drawing Rights in 2016, accounting for 10.92% of the total. The RMB has made a progress in four areas: international settlement, international reserves, valuation functions, and infrastructure. In 2023, RMB cross-border products were widely used by domestic and foreign enterprises.

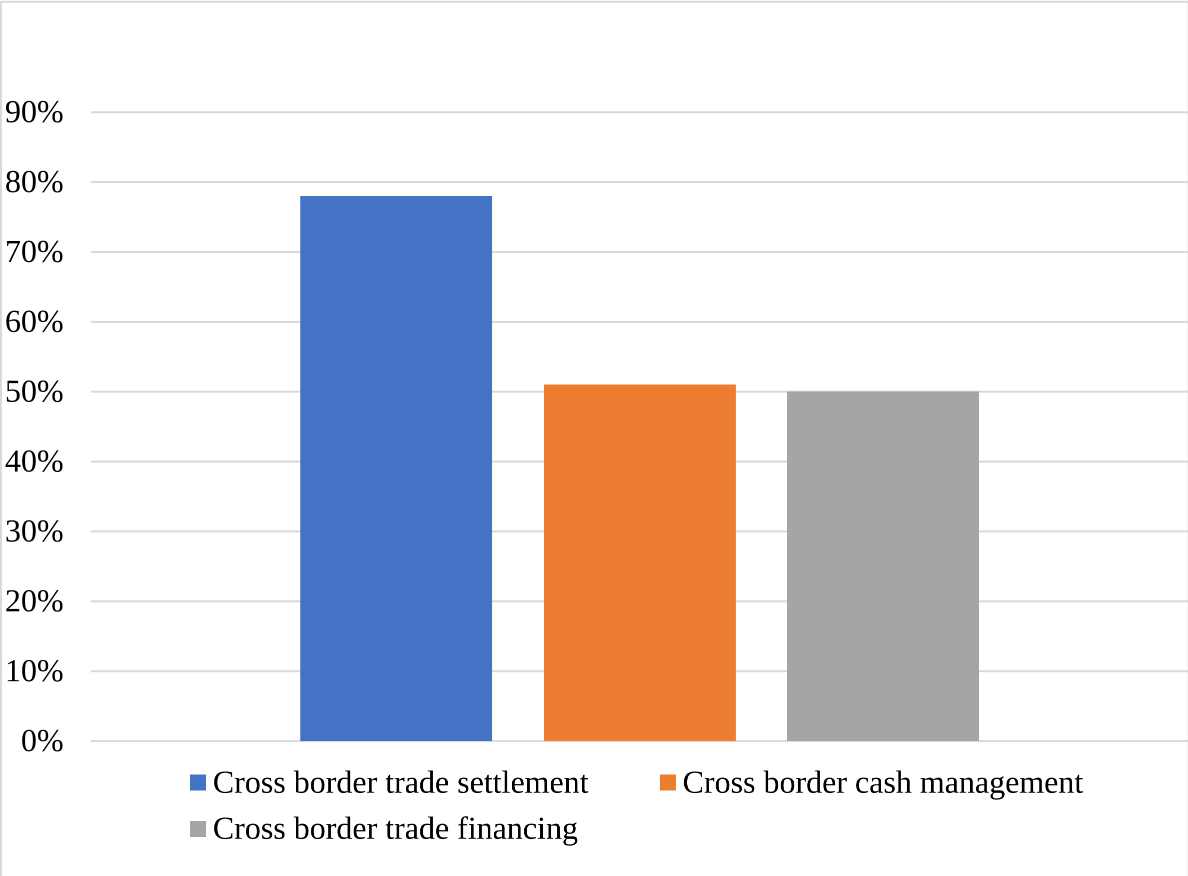

Fig. 1 Utilization rate of cross border RMB products of domestic enterprises

Data from https://bg.sgpjbg.com/baogao/180517.html

Figure 1 describes the top three most widely used RMB cross border products for domestic enterprises, with their usage rates of 78%, 51% and 50%, respectively.

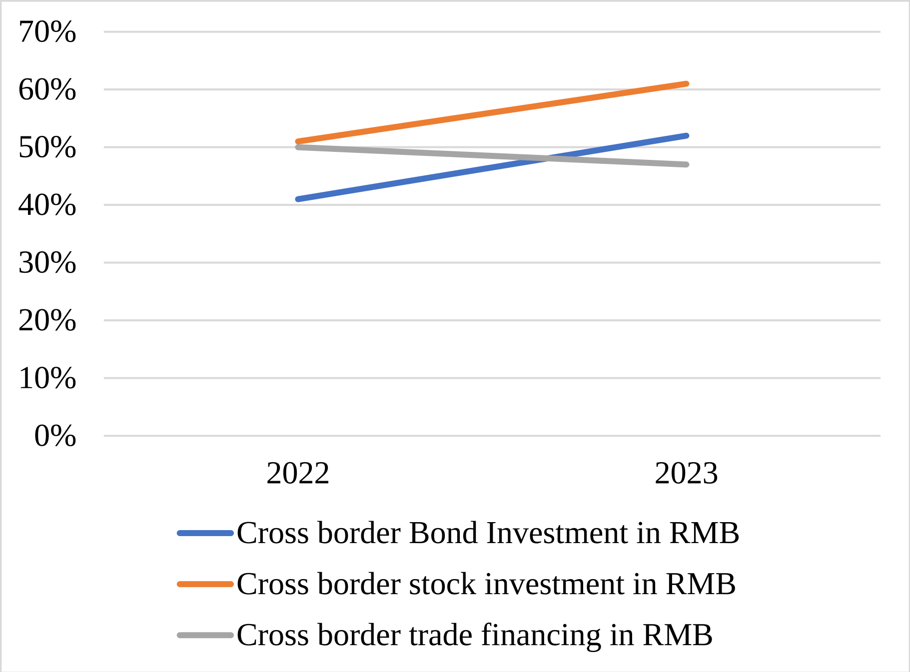

Fig. 2 Cross border RMB products of overseas enterprises

Data from https://bg.sgpjbg.com/baogao/180517.html

Figure 2 describes that the proportion of transnational stock investment in RMB and bond investments is 52% and 61% respectively, an increase of 11% and 10% from 2022, and the use of transnational trade financing in RMB has decreased from 50% in 2022 to 47% in 2023.

4. Path of RMB Internationalization

4.1. Trade Pricing

The internationalization of the RMB follows the functional expansion logic of "valuation-settlement-investment-storage-anchoring". Among them, the international pricing function is the starting point and cornerstone of RMB internationalization [3]. Looking back at history, in the 19th century, Britain was tied to coal resources, forming the "coal pound". In the 20th century, the United States and oil commodities were linked to form the "petrodollar". These cases demonstrate that binding energy commodities and pricing and settlement in the country's currency is an important reason why a country's currency can become an important international currency [4]. The internationalization of the RMB requires a deep binding with energy commodities, enabling other countries to increase their holdings of RMB assets for trading such energy commodities.

In March 2018, China's first international futures commodity, crude oil futures, priced in RMB, was officially listed for trading on the Shanghai International Energy Trading Center. Since then, the use of RMB in the field of commodity trade has steadily increased, and the pricing function of RMB has been preliminarily developed [5].

4.2. International Settlement

Although China's total international trade volume is huge, the proportion of trade settled in RMB is still comparatively low. In the past three to four years, the settlement of international trade in RMB has remained at around 20% of China's total import and export of goods. This proportion is seriously disproportionate to China's position as the world's largest trading nation in goods and the largest trading partner of over 140 countries and regions since 2013 [6].

In the process of international transaction settlement, reducing transaction costs is crucial for the use of currency. When the settlement usage of a currency is large enough, economies of scale can be formed, thereby reducing the transaction cost of settling a single transaction. Taking the US dollar as an example, its usage range is relatively large and its frequency of use is high, so the transaction cost is relatively low, and it is also relatively easy to be favored by most countries. However, compared to the US dollar, the development of the RMB settlement mechanism is not perfect, and the cost of the entire transaction process is relatively high, which makes the internationalization of the RMB slower [7].

To promote international settlement of RMB, the Chinese government is committed to building relevant hardware facilities. The Cross-border Interbank Payment System (CIPS) is an important hardware facility that is a wholesale payment system specialized in clearing RMB cross-border payments. Before the emergence of CIPS, there were mainly two channels for RMB cross-border clearing, namely the agency bank model and the clearing bank model. The traditional clearing mode has multiple levels, long clearing paths, and limited message compatibility, which to some extent affects clearing efficiency. The automation level of information submission is relatively low, requiring commercial banks to declare on their own, which affects the efficiency and accuracy of information submission [8].

Although the hardware facilities for international settlement of RMB are constantly being constructed, the utilization of settlement currency exhibits a certain degree of inertia.The RMB, as an international settlement currency, needs to be recognized and continuously used by many countries around the world to promote the continuous development of RMB internationalization.Over the past few years, the Chinese yuan has made a certain progress as a cross-border trade settlement currency. After Russia was excluded from the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system, the Chinese yuan gradually became the largest settlement currency on the Moscow Foreign Exchange. At the end of 2022, Saudi Arabia made its first cross-border payment of goods to China in RMB, which has a certain demonstration effect in the Middle East region. In March 2023, Saudi Arabia completed its first domestic liquefied natural gas (LNG) import transaction settled in RMB [9].

4.3. International Reserve

According to data from the International Monetary Fund, as of the end of 2022, central banks worldwide held RMB reserves valued at $298.4 billion, constituting 2.69% of the total, and positioned as the fifth-largest reserve currency. On May 11, 2022, the IMF Board of Directors conducted a five-year review of the SDR basket. The weight of the Chinese yuan has been raised to 12.28% (up 1.36 percentage points). The increase in the weight of the RMB reflects the rise in its international status since its inclusion in the basket [9].

To promote the RMB to become a reserve asset for more countries and strengthen the international recognition of the RMB by other countries, China mainly works through two paths. First, China promotes the signing of bilateral currency swap agreements, focusing on promoting countries along the "Belt and Road" to sign currency swap agreements. Secondly, China makes every effort to promote cross-border settlement of RMB and build a clearing network and offshore financial markets [8].

5. Conclusion

According to the international monetary function expansion logic of "valuation- settlement-investment-storage-anchoring", the first step is to increase RMB valuation weight in international commodity trade.Therefore, Relying on "the Belt and Road" initiative is of great significance for RMB internationalization.Firstly, through bilateral trade activities with "the Belt and Road" countries and settlement of energy commodity trade in RMB, the pricing weight of RMB will be increased.For example,by providing electricity to Southeast Asia, China can enhance the status of the RMB in the region. Secondly,Bilateral currency swap carried out through countries along "the Belt and Road" can provide support for bilateral trade settlement and bilateral investment. What’s more, Chinese exports of electric vehicles, mobile phones, and other products are attractive to foreign consumers.Settling

Chinese export products in RMB can enhance the acceptance of RMB by other countries in trade settlement. In addition, by strengthening the construction of the RMB cross-border financial market, countries holding RMB as foreign exchange reserves will have channels to invest in the RMB financial market, enabling them grow their RMB assets and complete the "investment" link in the expansion logic of the above functions. Finally, only after the RMB has completed functions of settlement and investment, do other countries have a sufficient willingness to hold RMB as foreign exchange reserves.

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