POLICYBRIEF
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Dollar centrality and Renminbi's rise: challenges and prospects

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President Donald J. Trump has increased the utilization of sanctions and the 'weaponizing' the US Dollar in order to attain auxiliary foreign policy goals. We argue that this creates challenges to China's process of internationalizing its currency, the Renminbi, but also opportunities to defy the increasingly coercive use of the US Dollar.

1. INTRODUCTION

The demise of the dollar has been predicted by pundits and analysts at least since the 60's. They gained traction in the 70's, to the point where there was a consensus not if the dollar standard was threatened, but when would it collapse. Then again, such arguments gained prominence after the financial crisis of 2008, seen by many at the time as the death-blow to an already unsustainable global and financial monetary architecture. Yet, paradoxically, there was a major run *to* the dollar, not *from* the dollar, reaffirming the safe-haven role of the US-dollar as world money.

Since then many reforms have gained traction such as the revision within the voting power of the IMF, the inclusion of the Renminbi in the SDR's basket, the strengthening of multilateral liquidity provision arrangements such as the Chiang Mai Initiative, China's implementation of its own bilateral swap arrangements, amidst other proposals to diminish the reliance by the global economy of the US dollar (Prasad, 2016).

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None of these has generated a significant shift away from the greenback. Nor should it: monetary standards have historically changed in very gradual fashion over the span of decades (Eichengreen, 2018). Yet, it is remarkable not only that the dollar has maintained its central position in the international hierarchy of currencies in recent decades, but also that the US has explored this power increasingly under Donald Trump's administration to pursue auxiliary foreign policy goals.

This is relevant for several reasons. Firstly, the power to 'weaponize' the dollar has profound policy implications for countries that are geopolitical rivals of the US, as the recent examples of Russia, Iran and Venezuela demonstrate. Secondly, it also raises significant questions as to what the role of the greenback in the context of China's rise will be. In spite of China's increasing economic importance and political ambitions, it is seriously constrained by the control of the US over the global currency. This is especially important in a context of global tensions around the US-China trade war.

2. PLUS ÇA CHANGE, PLUS C'EST LA MÊME CHOSE

While it is true that the dollar has lost at least some centrality since its heyday, data for the utilization of currencies in different roles shows that the greenback has maintained its centrality since the 2007/8 crisis. As a store of value, the dollar still represented 61,82% of all allocated foreign exchange reserves in the first quarter of 2019, 1,12% less than in the first quarter of 2008. During the same period, the euro has lost 6.21% of its share, denominating 20,24% of all allocated reserves in 2019 (IMF, 2019a).

This same pattern of relative stability in the utilization of the dollar and of a decrease in the role of the euro is seen in different currency roles. In OTC foreign exchange markets, the dollar still represented 88% of the daily turnover in 2016, 2% higher than in 2007. The euro went from representing 37% of the daily turnover in 2007 to 31% in 2016 (BIS, 2019). As a medium of payment, data starts only in 2011, but it shows that the dollar went from a share of 31% of all payments in Swift to 40% in 2019, whilst the euro went from 42% of all payments to 34% in the same period (SWIFT, 2019). In sum, data indicates that there has not been a significant decrease in the role of the dollar since 2008.

Such level of control over the global currency grants the US a significant capacity to exert pressure through financial means. In effect, the capacity to utilize the financial system as a tool of financial statecraft isn't new and economic sanctions as a tool for US foreign policy date back from the 19th century. Yet, coercive economic measures gained increased importance since the end of the cold war, and especially after 2001 when these efforts assumed the forefront in the fight against terrorism.

The key mechanism of financial statecraft is to prohibit individuals, corporations and entire countries to access the dollar "realm". In the words of Steven Mnuchin, US Treasury Secretary, "If you want to participate in the dollar system you abide by US sanctions" (Mallet, 2019, p.1). Given many non-US banks rely on access to the dollar and have business relationships with US banks, they must – even if indirectly - comply with the directives of the Office of Foreign Assets Control (OFAC), which currently administers 30 sanctions programs (Harell, Rosenberg, 2019). This tool has become especially useful in light of the change of foreign policy orientation under Donald Trump. In 2018, 1,474 entities were target with sanctions, a number that is 50% higher than in any previous year (Fleming, 2019).

From the financial point of view, most actors subject to the financial sanctions do indeed see mounting pressure to abide by the rules of the US. However, it creates strong incentives to diversify away from the greenback as an increasing number of countries see themselves being hurt by the US' aggressive stance. In Europe, for example, France, Britain and Germany have all called for greater European financial independence and led the initiative to establish a special purpose vehicle (SLV) named INSTEX to bypass sanctions and allow European companies to do business with Iran, other than promoting the utilization of the Euro to denominate imports of oil. Its limited success so far points to the difficulty of challenging the US Dollar, but it also indicates increasing frustration of historic allies of the US.

Pressure on China has also been acute. In late 2018, the US Congress enacted new legislation that increases the scrutiny of Chinese investments in the US, mainly in the technological field. In 2018 and 2019, both ZTE and Huawei, two major Chinese electronics companies, have been targeted with sanctions. Additionally, since President Trump announced the U.S. withdrawal from the Joint Comprehensive Plan of Action (JCPOA) in May 2018, China has reduced its imports of oil from Iran and also sought to limit exposure to possible sanctions. More significantly, Trump´s tariffs now reach more than half of all US imports of Chinese goods, putting pressure on China´s export sectors.

In face of such coercive measures from the US, China has accelerated the process of currency internationalization. The country has tried to internationalize its currency through an opening of its financial markets, namely the inclusion of Chinese bonds and stocks in a number of global indexes, coupled with the development of offshore financial centers, the expansion of investment abroad, the establishment of multilateral institutions, the construction of its own payment system, among many other actions to promote the utilization of China's currency, the Renminbi (Subacchi, 2017).

Yet, the contradictions of the current international monetary and financial architecture make it hard for any other currency to assume a significant role internationally. Currently the RMB is the currency of denomination of 0,43% of international debt securities, its participation in the daily turnover of global FX markets is of 4%, it represents 1,99% of all payments that go through Swift and 1,95% of all allocated foreign reserves (Bis, 2019; Swift, 2019; IMF, 2019). In May 2019, China's share of total goods trade settled in RMB was 14.6%, down from 34% in August 2015 (Standard Chartered, 2019).

For a currency that played virtually no role internationally 15 years ago, these numbers are remarkable. However, they also demonstrate that China's currency is still small compared the country's overall economic relevance. For example, if one divides the share of currencies in the daily FX turnover by their respective country's share in global imports and exports, it is notable how little utilized the RMB is compared to China's importance as a global manufacturer and consumer.

TABLE 1:

SHARE OF CURRENCIES IN THE DAILY TURNOVER OF FX MARKETS DIVIDED BY SUM OF THEIR IMPORT AND EXPORT SHARES IN GLOBAL TRADE (2016).

USA	JAPAN	AUSTRALIA	UNITED KINGDOM
3,98	2,86	2,72	2,13
SWITZERLAND	**EUROZONE**	**CANADA**	**CHINA**
1,57	1,03	1,03	0,17

Source: (Bis, 2019; Wto; 2019). Author's elaboration.

Moreover, as China opens up its markets, foreign ownership of domestic assets is booming. In the last five years, for example, foreign ownership of Chinese government bonds has more than quadrupled and the inclusion of the country's assets in global benchmarks could increase portfolio inflows in U$450 billion over the next three years (Chen, Drakopoulos and Goel, 2019). Yet, as the IMF (2019, p.33) points out, benchmark-driven investments are 'more sensitive to common factors affecting emerging countries and therefore correlated across countries', which increases the risk of excessive outflows unrelated to the fundamentals of specific countries.

Therefore, internationalizing a currency solely through markets can be tricky. In the words of Kroeber (2013), markets have shown to be in a way 'indifferent' to the internationalization of the Renminbi. Consequently, China's longer term institutional and political initiatives seem to be a more consistent policy towards internationalization of its currency than solely promoting market opening.

A good example of that is China's Belt and Road Initiative (BRI), which will play a key role is fostering RMB internationalization by promoting trade and investment conducted in the Chinese currency. In a 2019 survey by China Construction Bank with 402 companies, 117 overseas corporations and 43 financial institutions, 80% identified the BRI as the key driver to RMB internationalization (French and Mei, 2019). It can be reasonably expected that China's bold project will assume center stage in the process of making the 'People's Currency' an international money, principally in a context in which market forces are unlikely to be the sole driver of currency internationalization.

3. POLICY RECOMMENDATIONS

In light of what we have illustrated and argued, a few policy recommendations can be formulated. Firstly, it is worth mentioning that the increasing foreign ownership of domestic assets accompanied by the presence of "fickle" investors poses a significant risk to China's overall macroeconomic stability due to their sensitivity to "push" factors.

In this regard, fostering the expansion of Chinese finance and influence through BRI, among other similar initiatives to promote the use of the currency for infrastructure financing and emergency lending, indicates to be a better strategy than pursing increasing exposure to global risk factors as a strategy to internationalize the Renminbi. In other words, a strategy of internationalization of the Renminbi that is more resilient to swings in market sentiment ultimately grants China additional power to respond to US monetary and financial pressure.

Secondly, China should utilize the possible backlash from the increasingly coercive utilization of the dollar by the US to foster greater coordination in multilateral instances in order to curb the dollar's weaponizing. Europe´ INSTEX is a good example of how increasing regional monetary cooperation can help curb sanctions by the US, but also an important reminder of how complex it is to bypass the US-led international financial system. China's initiatives must strive for greater impact than INSTEX, mainly by tying such arrangements to the BRI and Chinese infrastructure finance. While geopolitical disputes become increasingly economic in nature, China would perform an important role if it were to become a more active vector of changes through multilateral monetary efforts.

Thirdly, initiatives to integrate an increasing numbers of institutions in China's own clearing and settlement network, China's Cross-Border Interbank Payment System (CIPS), are of central importance. As argued previously, the US dollar still dominates the global payment system, but CIPS has been steadily increasing its reach, with a roughly 15% growth in the number of transactions in 2018 (Kida, Kubota and Cho, 2019). In a context in which secondary sanctions are becoming more widespread and SWIFT is being increasingly pressured by US authorities, China should aim at supporting the further development of CIPS as a key strategy for the near future.

The Chinese currency still has a long road ahead before it can challenge the US Dollar in any significant manner. Yet, given the increasing momentum to challenge the utilization of the greenback, now might be the time to purpose bold multilateral efforts that could defy America's unilateral and arbitrary use of its currency as a geopolitical tool.

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