China's RMB project making steady progress

As China steps up efforts to graduate to a leading role in global currency markets, India faces a choice between aligning with the Western-dominated financial system and the Chinese one

Through various columns in this paper, I have followed developments in the internationalisation of the Chinese currency, the Renminbi (RMB). An update on the subject may be of interest since there have been several significant developments in the recent past, most importantly, the Ukraine War, the sweeping and unprecedented American sanctions against Russia and the resulting turmoil in the global energy markets.

The US' weaponisation of its domination of international financial and currency markets is leading countries across the world to hedge the heightened risks of their inordinate reliance on the dollar. These risks are exacerbated by the collateral damage from US monetary policies, including interest rate changes. China sees this as an opportunity to raise the international profile and role of the RMB.

SHYAM SARAN

Several countries, particularly in the global South, are looking for opportunities to conduct bilateral trade with partner countries in local currencies. Brazil has announced that it would opt for trade settlement with China in Chinese RMB/Brazilian reais, without intermediation through a convertible currency. The RMB-denominated oil and gas trade has made significant progress with countries like Iran and Venezuela, which are under severe US sanctions, and cut off from the dollar-dominated international financial market. Since the Ukraine War, Russia, one of the world's largest producers of oil, has joined their ranks, opting for a progressively larger proportion of its oil and gas trade with China being designated in yuan or the ruble. Most recently, the French company Total signed a yuan-denominated deal to supply LNG to China.

Similar arrangements may follow with China's other trade partners. But this does not add up to the RMB being used by countries for trade settlement with third countries. This is where a fully convertible currency like the US dollar has no peer. The daily turnover in global financial markets is currently \$7.5 trillion, and 88 per cent of this trade has the US dollar as the counterpart.

China has tried various means to reconcile its reluctance to adopt a fully convertible currency, with its attendant risks of volatility and capital flight, with its ambition to make it an international medium of exchange and a store of value.

One, it has pioneered the adoption of a central bank digital currency (CBDC), which may be used for cross-border transactions under strict state monitoring. The multiple CBDC project or "m-bridge" is of special interest. This is a cross-border payments pilot project of the Hong Kong Monetary Authority, the Bank of Thailand, the China Digital Currency Research Institute under the People's Bank of China, and the Bank of International Settlements (BIS) to "develop a proof-of-concept prototype to facilitate real time cross-border foreign exchange payments on distributed ledger technology." The first phase has concluded successfully and the next phase will soon commence.

Two, in June 2022, China promoted an RMB Liquidity Arrangement as a joint initiative with the BIS, "to provide liquidity support through a reserve pooling scheme", which could be used by participating central banks during future periods of market volatility. Central banks of Indonesia, Malaysia, the Hong Kong Monetary Authority, Singapore, and Chile will each contribute a minimum of 15 million RMB or dollar equivalent to the pool, which shall be maintained with the BIS. This initiative seeks to promote China's role as a financial guarantor of sorts, reviving the earlier idea of an Asian Monetary Fund, which had emerged in the wake of the Asian financial crisis of 1997. With more participants, particularly in the Asian region, this could be the beginnings of a Yuan currency area in Asia.

Three, it has leveraged its status as the largest importer of oil and a substantial importer of gas and LNG, to create an RMB-based energy market in Asia. This may initially be on a bilateral basis but eventually graduate to a full-fledged global market, where yuan-based transactions may also be carried out for non-China related oil and gas trade. During his visit to Saudi Arabia in December 2022, Chinese President Xi Jinping proposed to his hosts that the oil exporting Gulf countries could use the Shanghai Petroleum and Gas Exchange (SPHGX) to sell oil and gas not only to China but other Asian countries as well, denominated in the RMB. The Shanghai International Energy Exchange, a counterpart organisation, provides a market for derivatives, options, spot oil, natural gas and LNG trade. This should enable the emergence of a truly Asian index based on local supply and demand and the relative weight of Asian producers and importers. This may be on a limited basis to begin with and expanded later as the density of the market increases. Trade based on the Shanghai benchmark is now third behind the US-based West Texas and the London-based Brent indices. In order to make the Shanghai exchange more attractive and reduce risk, China has allowed RMB proceeds from the oil and gas trade to be converted into gold at the Hong Kong and Shanghai Gold Exchanges, respectively. However, Chinese oil imports were \$400 billion in 2021 and constituted only 2 per cent of the total global oil trade of \$22 trillion, so one must not exaggerate the leverage this provides.

China may be able to promote the use of Chinese currency in settling such bilateral deals, but in settling multilateral transactions, the US dollar continues to rule. Nevertheless, as the world's second largest economy, its largest trading power and substantial investor overseas, China may eventually graduate to a leading role in international financial and currency markets. The economist Kenneth Rogoff has said,"...my guess is that over time Asia would coalesce, not around the dollar but around the RMB. Then we'd be in a world where the RMB would be a regional currency in Asia, the Euro would be a regional currency in Europe and the dollar would have everything else."

Should India get on the inside track of these developments, as it did with the Asian Infrastructure Investment Bank and the BRICS Development Bank? Should it play a more active role in promoting the BRICS trade settlement mechanism in local currencies? Or are its economic and geopolitical interests better served in integrating more closely with the existing financial order dominated by the West? These are important questions worthy of careful study.

The writer is a former foreign secretary and an honorary fellow, Centre for Policy Research