

The Potential Dominance of Renminbi as an International Reserve Currency

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Abstract: The spread of the global corona virus and geopolitical risks in recent years have directly led to the short-term economic recession in the United States. The Biden government's fiscal deficit and national debt have repeatedly hit record highs, which are likely to cause inflation and price fluctuations. This study focus on the key nature of the international reserve currency and its trend of excessive privilege of the US dollar whilst facing the economic rise of China. Through the macro-control plan of the New Silk Road, the Renminbi is gradually consolidating and developing emerging economic and trade regions in Southeast Asia and Central Asia. This paper also analysis the opening of China's financial market and the continuous inflow of foreign capital, it is expected to increase the use of the Renminbi, and it is predicted that the Renminbi will replace the British pound and the Japanese yen in 2030 and become the world's third largest foreign exchange reserve currency. But even if China is accelerating the implementation of digital Renminbi, the major difficulty of replacing the US dollar lies in the Chinese government itself, i.e., the monetary policy and the number of restrictions that apply on its currency circulation.

1. Introduction

The spread of the global corona virus and geopolitical risks in recent years have directly led to the short-term economic recession in the United States. The Biden government's fiscal deficit and national debt have repeatedly hit record highs, which are likely to cause inflation and price fluctuations. For the future long-term development of the US dollar, international trends in this regard have been alarmed. Although the US dollar can maintain the key nature of the international reserve currency, it is gradually losing its trend of excessive privilege and the US dollar is currently facing the economic rise of Chinese mainland. Through the macro-control plan of the New Silk Road, the Renminbi is gradually consolidating and developing emerging economic and trade regions in Southeast Asia and Central Asia. However, the U.S. dollar is still the most important international reserve currency in the overall global financial system, and at the same time, the U.S. dollar maintains the current global main value reserve and trading medium^[1]. The U.S. Federal Reserve provides inter-bank loans with low interest rates and low base periods. In advance, foreign institutions borrow government bonds and stock funds in US dollars. Short-term hot money has been abundant and overflowing. The spread of the corona virus in recent years is similar to the global financial tsunami and the millennium financial crisis. The economic recession cycle of the

initial bubble, geopolitical risks and the global spread of the corona virus will not shake the key nature of the US dollar as an international reserve currency. In addition, leading credit card companies in the United States (including American Express and MasterCard, etc.) handle more than 70% of the world's credit card payments. At the same time, US investment banks receive an average of more than 60% of the world's investment underwriting fees each year. Therefore, many US commercial banks, investment businesses, insurance companies, leading credit card companies, etc. continue to dominate the global financial system exclusively. These numerous financial institutions maintain the high privilege of consolidating the US dollar. The US dollar is still the international reserve currency for settlement by multinational banks^[2].

With the opening of China's financial market and the continuous inflow of foreign capital, it is expected to increase the use of the Renminbi, and it is predicted that the Renminbi will replace the British pound and the Japanese yen in 2030 and become the world's third largest foreign exchange reserve currency. But even if China is accelerating the implementation of digital Renminbi, the key to the difficulty of replacing the US dollar lies in the Chinese government itself. At present, the Renminbi accounts for about 2% of the global central bank's foreign exchange reserve assets. If it is to replace the yen and the pound, the proportion will have to rise to 5-10%. The report is estimated based on 2021 data and predicts that foreign capital will be included in China Securities and China Bond as its global investment portfolio, which will accumulatively introduce 3 trillion U.S. dollars of capital in the next 10 years. In view of the accelerated opening of China's financial market and the increase in cross-border transactions denominated in Renminbi, it is not unrealistic to increase the proportion of Renminbi in global reserve currency assets to 5-10% in the next 10 years.

2. Renminbi Internationalization

The ancients used shellfish to make money and exchange paper for gold. Currency has always been an important pricing standard and transaction medium. There are also differences in currencies of different countries. Therefore, experts and scholars have developed many ways to measure currency. Among them, Benjamin J. Cohen mentions that the currency is divided into seven layers based on the image of a pyramid, and Susan Strange divides currency into four functional categories. In terms of pyramid levels, the US dollar is at the top of the pyramid, and it is the first choice of companies and countries in terms of international circulation and use, and it is relatively stable. On the other hand, the Renminbi is an elite currency located in the third tier. A small number of neighbouring countries use Renminbi as a medium of exchange, but the degree of expansion and frequency are not high. According to Susan's classification, the Renminbi is a neutral currency. Although it has a certain influence on the market, its degree of internationalization is slightly eclipsed^[3].

Currency internationalization generally means that a country's sovereign currency is widely used in international economic, trade and financial activities, and as a result, it has been widely entered into the balance sheets of overseas entities as a vehicle currency. The internationalization of Renminbi refers to the process in which the Renminbi crosses national borders and circulates outside the country to become an internationally recognized currency for pricing, settlement and reserve. The internationalization of the Renminbi is an inevitable trend for China's economic expansion and strength enhancement. Also, it will mean that the Renminbi is widely recognized and accepted in the international market, and functions as a unit of calculation, a medium of exchange, and a store of value, that is, becoming an international settlement, investment currency, and reserve currency^[4].

Becoming an international currency is not so simple. In order to be widely used by the international community, it must first have the convenience of exchange and high liquidity. The

currency also needs a strong trading network, and the strong circulation makes other countries generally support the use of the currency. In addition, everyone has confidence in the future of this currency, and only if they trust the stability of this currency can they hold the currency and then use it for transaction settlement and storage investment^[5-6].

In order to stabilize China's planned economic development and exchange rate, strong capital control is one of the highest priority policies of China today. Although China has a strong trading network, but the inconvenience of exchange and outflow has made it impossible for the Renminbi to advance to a higher level of currency. Generally speaking, the essence of Renminbi internationalization should include three aspects and firstly the circulation of the Renminbi should be wide and which Renminbi should enjoy a certain degree of circulation abroad, and in international trade, its transactions settled in Renminbi must reach a certain proportion. Secondly, there should be more investment products that are based in Renminbi and if financial products denominated in Renminbi that can be accepted internationally and become the investment tools of major international financial institutions and which including the important investment tools of central banks and other financial institutions in various countries^[7-9]. Lastly, most countries in the world should accept Renminbi as their reserve currency and if the Renminbi being generally accepted by the international community and becoming the main tool of circulation or trading. This will be a general standard for measuring whether Renminbi can be used as an international currency.

3. Cost and drawbacks of Renminbi Internationalization

In practice, the internationalization of the Renminbi will bring certain constraints and negative effects on the formulation and implementation of China's economic policies. For example, large-scale of the currency demand may cause the formulation and implementation of monetary policy to become passive, and the effectiveness of China's monetary policy may be affected while as an international currency, the international movement of funds through its medium will affect China's interest rate and exchange rate level. After the internationalization of the Renminbi, it will also undertake the task of international financial stability. When the international financial market is impacted, it should act as the regional lender of last resort when necessary^[10].

The internationalization of a country's currency recommends that the country's currency should be fully convertible, but the Renminbi is currently only a convertible currency for the current account, and the capital account is still subject to limited controls. After China's accession to the WTO, if the financial market is fully opened up, more than 70% of China's banks, securities companies, and insurance companies will face the risk of bankruptcy.

The stability and rapid development of China's economy has great significance to the East Asian economy and global economic and financial stability. However, many countries remain vigilant and the Renminbi may also encounter certain prejudice or even hostility as a result. Once the Renminbi becomes stronger and stronger, the US dollar and the Euro, which are the world's major reserve currencies, will be greatly affected. The US government may also actively engage in order to maintain world economic hegemony. The relatively strong Yen in Asia will also be affected^[11-12].

After a country's currency is internationalized, its domestic financial market must be free and open. After the currency barrier disappears, the outflow and inflow of hot money can be unimpeded, and it will affect the domestic currency supply. The impact of the currency supply will also affect the exchange rate and the entire domestic economy and the cost of speculative shocks is unavoidable. The risk of Renminbi as an international currency is far greater than that when it is not freely convertible under regulatory conditions. The risk is greatly enhanced during the transaction and will be resolved by various methods of avoiding risks, market means and various financial instruments. After the internationalization of the Renminbi, the financial development and financial

structure need to complement each other. Otherwise, the Renminbi will achieve internationalization, but the financial structure and financial development cannot adapt to each other, and its financial risks will naturally increase. After the releasing the restraints of interest rates, most companies in China may lose the benefits of the low interest rate policy that the country has implemented for a long time. Under the condition of floating interest rates, once the interest rate rises, the cost of domestic enterprises and operators will rise, which will ultimately affect the overall interests of the national economy and of course the growth rate. Therefore, free-floating interest rates will increase the scale and speed of international capital movement under the conditions of capital account opening, thereby expanding transaction costs and increasing risk factors^[13-15].

After the internationalization of the Renminbi, the central bank will regulate its economic goals, it must take into account that the overall domestic economic situation on the one hand, and the factors of changes in the world economy on the other hand. From the perspective of the impact of policy changes on the domestic and international economy, in this case, there must be a balance and coordination of domestic and foreign policy objectives. If necessary, some aspects of the domestic economy may be lost for the sake of international economic goals. The central bank's monetary policy objectives must be considered from a global perspective, which also increases the difficulty of regulation. The central bank and the central banks of other countries have become closer in terms of information, processing, currency cooperation, and target policy coordination. At the same time, the central bank's regulation of has increased its economic cost.

The process of currency internationalization of a country is generally accompanied by a certain degree of currency appreciation and that applies confidence cost. For currency issuing countries, continuous and substantial appreciation will bring many adverse effects. The first is the potential for imbalances in foreign trade balances. At the same time, in the process of currency internationalization and after obtaining international currency status, it has a duty to maintain the confidence of foreign currency holders in their own currency. Changes in the financial situation may also adjust policies in order to fit in the convertibility requirements. The internationalization of currency has made the connection between China's domestic and foreign financial markets increasingly close. In this case, there will be spill over effect in China. Development may constrain the flexibility of the domestic monetary policy which central bank policies may not be able to affect, or only a small part of it can affect the domestic economic variables and monetary policy may not reach the predetermined ultimate goal and also foreign feedback effects may imply.

4. Renminbi becoming dominance international currency reserve

The meaning of Renminbi internationalization includes several aspects and general standards for Renminbi internationalization which according to the above-mentioned currency internationalization standards, Renminbi internationalization is still at an early stage. In order to promote the internationalization of the Renminbi and make it technically feasible, we must first expand the use of the Renminbi abroad, and it must be available abroad. Based on the past experience of the United States, the way for the U.S. dollar to become an international currency is to donate U.S. dollars through the foreign aid program at the beginning, and then it will generate a huge trade deficit, so that U.S. dollars can be paid.

However, the mainland still has a huge trade surplus. If it reverses the situation and it will immediately cause a trade deficit, this will affect the long-term economic development. Therefore, the full internationalization of the Renminbi does not have the immediate and feasible conditions.

In fact, as far as the United States is concerned, American economist Robert Triffin pointed out that because of the U.S. dollar is linked to gold and the currencies of other countries are linked to the U.S. dollar, in order to develop international trade, other countries have to use U.S. dollars. As a

settlement and reserve currency, this has caused the currency flowing out of the United States to continue to precipitate overseas. For the United States, a long-term trade deficit will occur. The prerequisite for the U.S. dollar as the core of the international currency is to maintain the stability of the U.S. dollar currency, which in turn requires the U.S. have to become a long-term trade surplus country. After the Second World War, the United States had a surplus in both the trade and capital accounts, but through the Marshall Plan, this dilemma was temporarily avoided. Afterwards, the Triffin cross-border settlement problem eventually led to the Bretton Woods System in the early 1970s. It collapsed and changed to a linked floating exchange rate system.

Later, the American economist Robert Mundell put forward the famous The Impossible Trinity. There are three main monetary and economic goals of a country according to the above rule which are the independence of the country's monetary policy, the stability of exchange rates and the complete flow of capital. A country can only choose two from those three goals and it is impossible to have them all. According to the Bretton Woods System, the independence of monetary policy and exchange rate stability of various countries were realized, at the same time, the capital flow would be severely restricted. After 1973, monetary policy independence and free capital flow were realized, but on the other hand, exchange rate stability no longer existed. The advantage of The Impossible Trinity is that it provides a clear way to divide the international economic system. Obviously, the Renminbi has to take the path of internationalization, and it will eventually enjoy the advantages like the US dollar.

The special interests of rights naturally cannot be separated from the limitations of Triffin Dilemma and The Impossible Trinity. Considering the situation in Chinese mainland, the foreign trade current account and capital account maintain a long-term surplus, and it is not difficult to maintain a stable exchange rate. In recent years, the mainland's foreign investment has gradually caught up with foreign direct investment, and the balance of payments capital account surplus has gradually balanced, but the current account surplus makes the "Triffin Dilemma" still exists.

In terms of the turbulence in the domestic and international economic situation, independent monetary policy is indispensable, and the goal of free capital flow has naturally become the goal of abandonment. Although the restriction of The Impossible Trinity is avoided, capital cannot flow freely, which strictly restricts the internationalization of the Renminbi from getting progress.

Considering the situation in Chinese mainland, the gradual development strategy of Renminbi internationalization can be considered and designed from different perspectives. Firstly, by promoting the peripheralization of Renminbi and the circulation of Renminbi in Hong Kong, Macau, Vietnam, Laos, Myanmar, Nepal, Mongolia and other surrounding countries and regions and then it will imply regionalization, and continuously improve the status of the Renminbi in other Asian countries, so that it will gradually become the dominant regional currency. It has also adopted a three-step approach to currency functions, that is, gradually realizing the orientation of Renminbi settlement currency, Renminbi investment currency, and Renminbi reserve currency. The Renminbi can in turn become the trade settlement currency of neighbouring countries. Secondly, from the perspective of mainland's economic system reform, the past reform method can also be applied to promote the internationalization of the Renminbi. This includes measures such as progressive capital account convertibility and improving the efficiency of the financial system. Examples of such improvements include the establishment of programs like the overseas qualified institutional investor program and the domestic qualified institutional investor program. Additionally, allowing overseas companies to issue stocks and bonds domestically, as well as actively encouraging and promoting foreign trade companies and overseas transactions settled in Renminbi, are also important aspects in this regard. The purpose is to form a Renminbi financial market that competes with euro securities and US dollar securities as soon as possible. It has to take into account the actual financial conditions and furthermore the Renminbi capital account is not fully opened, in

order to promote the internationalization of the Renminbi, it has to get through the cross-border trade Renminbi settlement and also getting help from the development of the Hong Kong financial market. Taking in to account of the development of the onshore financial market is lagging, the development of the offshore financial market can be used to play the role of a firewall in order to isolate the impact of the internationalization of the Renminbi on the mainland financial market, especially the impact of short-term speculative capital.

The above two main factors have strengthened the development of the dual international reserve currency of the US dollar and the Renminbi. First, the Renminbi usually affects the exchange rate spreads around the world. The empirical research points out that the Renminbi trade ecosystem accounts for approximately 40% of the world's economic output. The international reserve currency chosen by the central banks which is highly correlated with the cross-border trade structure. The close relationship fully reflects the national conditions and the trade needs. Since the International Monetary Fund giving Renminbi the special drawing rights, and the total quality of Renminbi as an international reserve currency has gradually increased. If Chinese banking regulators take advantage of the trend to remove cross-border capital controls, there will be many international central banks are very likely to use their gold as a financial intermediary channel to purchase Renminbi.

In addition, China has signed currency swap agreements with more than sixty countries over 500 billion U.S. dollars. Many international central banks and financial institutions have pledged to allocate more than 10% of their deposits and properly allocate Renminbi. As a result, the total global foreign exchange reserves of China's original Renminbi have rapidly increased from 200 billion to over US\$800 billion. Secondly, China is gradually opening up cross-border capital flows to the real economy of the international Renminbi. Major global stock, debt index and credit rating agencies have summarized its Chinese stocks and bonds as Asian benchmarks. These leading indicators have helped Chinese government bonds widely attract more than 60 billion. However, at present, foreign institutional investors only hold less than 9% of Chinese government bonds comparing with European and American stocks and bonds. Many international asset management companies have focused on the multi-angle investment layout of Chinese stocks and bonds. These companies include BlackRock, Pioneer, State Street, Allianz, Goldman Sachs, Franklin, Fidelity, etc. The Chinese authorities need to build a new type of financial technology and an international investment system for foreign banks, and handle them properly with safe and stable cross-border payments and asset allocation, long-term savings in the handling costs and time gaps of traditional international wire transfers.

Chinese mainland has developed a new type of financial technology mobile payment system, including Alibaba Alipay and Tencent WeChat Pay, which are used to supplement traditional international wire transfers and actively save international wire transfer fees. At present, the digital wallets of Alipay and WeChat Pay each cover more than one billion users and account for 60% of China's in-store payments. At the same time, these digital wallets account for more than 75% of China's total online e-commerce sales. Chinese banks and technology leaders will continue to enrich and strengthen the digital financial life in the Asia-Pacific region.

Cross-border payments usually require the Global Telecommunications Association to regularly record international wire transfers, and high-value international wire transfers must go through the international correspondent banking system. Generally, international wire transfers are arranged on a peer-to-peer basis. The domestic bank maintains sufficient deposits in the foreign bank. Whenever the domestic bank's retail customers need to remit wire transfers to the foreign bank, the banks of both parties instruct the international correspondent bank's current deposit quality. It is difficult for most international wire transfer agency banks to replicate the global cross-border payment network ecosystem. This complex network usually results in slow and expensive cross-border payments. Chinese banks and technology leaders have tried to significantly reduce the frequency of

interactions between international wire transfers and moderately alleviate this short-term funding demand. Alibaba Alipay and Tencent WeChat Pay have taken advantage of the trend to build an international cross-border mobile payment network platform. These financial technology innovations in Chinese mainland have become a direct competition business model between traditional international wire transfers and credit cards.

Also, due to the international low interest rate monetary policy and the expensive operation of mobile payment systems in recent years, Chinese banks are trying to actively expand the scale of Renminbi lending through cloud financial services. These Chinese banks use third-party professional cloud service providers to integrate their user data with Private files, secure storage and high-performance cloud-based server. At the same time, Alibaba and Tencent use artificial intelligence facial recognition software to accurately verify the real identity of Renminbi users. These financial technology developments have gradually expanded the wide range of Renminbi application.

During the transition period when the Renminbi is challenging to become an international reserve currency other than the U.S. dollar, at least three major risks need to be overcome and firstly, if the Renminbi becomes an international reserve currency, it will accelerate the equilibrium and stability of the global financial market. In response to the financial crisis, these new regulations have helped improve the efficiency of the international financial system. However, financial supervision agencies around the world usually require multinational banks to establish local sub-banks, as opposed to branch branches, so that financial supervision agencies can more effectively supervise and manage international banks and local sub-banks. At the same time, these financial supervision institutions usually actively require multinational banks to independently operate most of their core businesses, such as cross-border payment and settlement, liquid capital supervision, offshore international bank funding, etc. The local subsidiary bank should maintain the main core operating functions steadily, and often need free capital support assistance of the parent bank. In the current international financial system, the top four Chinese banks still need to expand the extensive use of Renminbi, effectively promote the settlement operation function of cross-border payments, and properly manage the allocation of offshore liquid capital.

Furthermore, geopolitical tensions have exacerbated the risk of global asset market volatility. At the same time, the rampant global spread of the corona virus in recent years has severely affected the international economy. The asset portfolios of countries around the world tend to reduce international multi-angle operations. This global asset market concentration is very likely to force international commercial banks to redeploy. The asset allocation of stocks and bonds in the United States, the United Kingdom, Europe, Australia, China, India, Russia, Brazil, Turkey, South Africa, and other emerging countries will result in excessive global asset concentration. The global total economic output value and future asset returns will rapidly decrease by 3% to 5%. For the cross-border application of the Renminbi, local regulations focus on the data economic security of financial risk management and the integration of the dual international reserve currencies of the US dollar and the Renminbi is likely to cause the global financial system to become fragile and imbalanced. International commercial banks, insurance businesses, leading credit card companies, and new financial technology will provide cyber-attacks on hackers, more frequent breakpoints of international connections, geopolitical tensions and the threat of the spread of the corona virus, which usually aggravate the risk of shocks in the international capital market.

Finally, the global financial system dominated by the US dollar has created the dual development of international economic growth and full employment for decades and with the assistance of the World Bank and the International Monetary Fund, the United States has actively maintained the universal values and common interests of world peace and prosperity. The Renminbi financial system is in sharp contrast with the US dollar system. Chinese mainland is ready to indirectly lead

the new supervision order of international finance through dual international reserve currencies. At present, China is still striving to open the Renminbi financial asset market. At present, China cannot use these free capital market mechanisms to avoid excessive state control intervention and smoothly help safeguarding the public interest. This kind of international suspicion and concern will restrict the financial influence and wide acceptance of the Renminbi.

The U.S. dollar is still the most important international reserve currency in the global financial system. At the same time, the U.S. dollar maintains the current world's main value reserve and trading medium. This high privilege has caused the Federal Reserve Bank of the United States to naturally become the global financial market's benchmark. The Federal Reserve Bank of America provides inter-bank lending with low interest rates and low base periods which indicates that foreign institutions can borrow government bonds and stock funds in US dollars. The financial tsunami and the economic recession cycle in the early millennium, geopolitical risks and the global spread of the corona virus will not shake the key nature of the US dollar as an international reserve currency.

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