
| RESEARCH ARTICLE

Current Status and Promotion of the Circulation of RMB: Taking the Belt and Road Initiative as an Example

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| ABSTRACT

Achieving regional economic prosperity requires stable trading currency from the countries within the region and avoiding external risks by the use of currency from other currencies. With the Belt and Road Initiative, smooth trade and financial integration in the regions along the Belt and Road have been promoted, and the key trading currency is needed to maintain the economy and trade. So, it creates great opportunities for the promotion of RMB in the region, which pursue a higher international influence. However, there are still various obstacles to promoting the cross-border use of RMB and becoming a key currency in the "Belt and Road" region because of the unstable regional financial system, currency inertia and lack of financial infrastructure. To promote the use of RMB in the region, it is necessary to further strengthen financial cooperation with countries in the region, promote the function of the value scale, improve the offshore RMB market, and promote the construction of financial services infrastructure, promote financial development and service infrastructure construction.

| KEYWORDS

Financial cooperation, cross-border capital, RMB

| ARTICLE INFORMATION

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1. Introduction

Since the initiative was advanced in 2013, 140 countries and 32 international organizations have signed agreements and cooperation with China. The Belt and Road Initiative promotes regional economic development. Economic and trade development cannot do without currency. Choosing the currency of sovereign countries in the region as the transaction currency can effectively avoid the exchange transaction costs caused by using other currencies of extra-regional countries. It can also reduce the risk of monetary shock effects from outside the region. So it can help companies within the region do business with less risk so their transactions won't be marred by sudden or extreme changes in currency values. And it can promote an omnibearing and deep-seated strategy of regional cooperation. Therefore, it is very important to choose which currency is the key currency to be used in the "Belt and Road" region.

In recent years, Renminbi (RMB) internationalization has also entered a critical period of development. The 14th Five-Year Plan proposes to promote RMB internationalization steadily and prudently, adhere to market-driven and independent choices of enterprises, to create a new type of mutually beneficial cooperative relationship based on the free circulation of RMB. The Belt and Road Initiative focus on policy coordination, facilities connectivity, unimpeded trade, financial integration and people-to-people bonds. As unimpeded trade and financial integration coincide with the goals of RMB internationalization, the Belt and Road Initiative brings great opportunities for the free circulation of RMB within the region.

2. Feasibility of RMB circulation within Belt and Road region

RMB satisfies the requirements of transaction currency in the Belt and Road region. As China is the most important trading partner of the countries along the Belt and Road region, the scale of trade with these countries has continued to expand in recent years. In 2021, the volume of trade between China and countries within the region reached 11.6 trillion yuan, increasing by 23.6% year on year, which was the highest value in eight years. The scale of China's foreign investment in countries within the region was also growing rapidly. In 2021, China's direct investment in the "Belt and Road" region reached 138.45 billion yuan, increasing 7.9% year on year, accounting for 14.8% of China's total foreign direct investment. The enormous trade and investment cooperation has great demand for currency transactions and settlement. With the Belt and Road regional cooperation mechanism, using RMB as the trade settlement currency and expanding the scale of trade will effectively promote the circulation of RMB in the region (Du & Hu, 2021). What's more, China seeks to enhance financial cooperation with countries along the Belt and Road, improving payment and settlement infrastructure (Chen & Cheng, 2019; Lin, 2021; Cai, 2022). It would make more central banks of countries along the Belt and Road more willing to hold RMB-denominated assets as reserves. Promoting the circulation of RMB in the Belt and Road region is significant in promoting the reform, opening and steady growth of Chinese capital markets. First, the process of RMB internationalization follows the path of "peripheralization-regionalization-internationalization". The Belt and Road Initiative provides a good opportunity for the regionalization of RMB. Using RMB as transaction currency within the region will help avoid exchange rate risks and reduce currency exchange transaction costs (Li, 2020; Cheng & Li, 2021). It will provide more convenient cross-border settlement and payment services for economic and trade exchanges with countries along the Belt and Road. Secondly, the Belt and Road initiative will promote more Chinese-funded financial institutions to open branches in countries along the route to provide cross-border financial services for customers. It will enhance the internationalization and marketization of Chinese-funded financial institutions. Thirdly, using RMB in investment and financing is necessary to establish a perfect RMB financial market which has enough RMB-denominated financial products. It needs to monitor and regulate the establishment and perfection of the RMB off-shore financial market (Lu, 2022; Zhang et al., 2022). That will promote the establishment of a multi-channel, market-oriented and sustainable cross-border RMB capital supply mechanism and create a more convenient RMB cross-border investment and financing system (Cao & Dai, 2021; Yu & Yu, 2021). That will further speed up and deepen Chinese financial reform. Last but not least, Finally, as the sovereign currency of major countries in the region, if the RMB becomes the main transaction and settlement currency of the Belt and Road Initiative, that will help reduce dependence on third-party currencies and enhance resistance to external risks (Li, 2021). It is conducive to maintaining the stability of the financial system in the region.

3. Current status of the RMB circulation in the Belt and Road region

3.1 The RMB cross-border settlement capability was further enhanced

Since the RMB was added to the Special Drawing Rights (SDR) currency basket, the scale of cross-border trade settlement in the RMB has continued to rise, and it has become the fourth largest payment currency in global trade. With the deepening of trade and financial cooperation between China and countries along the Belt and Road, progress has been made towards the promotion of RMB circulation in countries along the route. In 2020, the amount of RMB cross-border receipts and payments in regions along the Belt and Road exceeded 4.53 trillion yuan, including 870.097 billion yuan for trade in goods and 434.116 billion yuan for direct investment, increasing 65.9% year on year. That accounted for 16.0% of total cross-border payments using RMB. In addition, RMB currency exchange is also more convenient. The RMB can be directly converted into currencies of 9 neighboring countries, including the Malaysian Ringgit, Singapore Dollar, Thai Baht and so on. And it conducted regional transactions between the Renminbi and currencies of 3 countries, including Kazakhstani Tenge, Mongolian Tugrik and Cambodian Riel. The cross-border settlement of RMB in the Belt and Road region has reached a certain scale. And the cross-border settlement capability has been further enhanced. That effectively avoided the exchange risks caused by the large fluctuations in international currency exchange rates and effectively reduced transaction costs. The RMB circulation within Belt and Road region will make trade and investment between China and countries along the route more convenient.

3.2 The RMB investment and financing channels have shown diversification

With the Chinese finance market opening, it has provided diversified RMB investment and financing channels for global investors. The interconnection mechanism between the financial markets of China and the countries along the Belt and Road has also been gradually improved. Investors in the countries along the route may access the Chinese domestic finance market through multiple channels such as the Shanghai-Shenzhen-Hong Kong Stock Connect, the Bond Connect (multi-tiered custody), the Global Connect (direct holding), the Qualified Foreign Institutional Investor (QFII) programs, the RMB Qualified Foreign Institutional Investor (RQFII) programs and so on. Chinese domestic investors may also invest in RMB-denominated financial products issued in countries along the Belt and Road region through the RMB Qualified Domestic Institutional Investor (RQDII) programs. The RMB-denominated financial products issued within Belt and Road region were becoming more and more diversified. In 2019, there were more than 40 billion yuan of panda bonds issued by the institutions of neighboring countries and countries along the Belt and Road region, accounting for 68% of the total issuance amount that year. The financial markets between China and countries within the Belt and Road region are more and more interconnected, facilitating financial accounting and funds management.

3.3 The financial cooperation with countries along the Belt and Road has been deepened

Currency and financial cooperation between China and countries along the Belt and Road has been deepening. China has signed bilateral local currency swap agreements with the central banks or monetary authorities of 23 neighbouring countries and the countries along the Belt and Road, such as Russia, Indonesia, the United Arab Emirates (the UAE), Egypt and Turkey. What's more, China has signed bilateral local currency settlement agreements with nine neighbouring countries and the countries along the Belt and Road, such as Vietnam, Laos, Russia, and Kazakhstan. It can improve RMB liquidity support for the offshore RMB market and the Belt and Road region, providing more convenience for the use of RMB. Using the RMB increasingly in cross-border settlement would help businesses to mitigate foreign exchange risk and reduce settlement costs from trade and investment along the Belt and Road. As the RMB continues to hold the third-largest overall share within the SDR basket and the 5th largest in the International Monetary Fund (IMF)'s Currency Composition of the Official Foreign Exchange Reserves (COFER), more and more central banks and monetary authorities increase their RMB reserve to manage their risk by diversifying their foreign exchange reserves. In 2021, the size of the RMB reserves reached US\$336.1 billion, and more than 70 countries accepted RMB in their foreign exchange reserves, some of which were along the Belt and Road. In addition, China has established RMB clearing arrangements in more than 10 along the Belt and Road. The Cross-Border Interbank Payment System (CIPS) covers more than 70 countries along the Belt and Road, establishing an efficient, safe and stable important channel for RMB settlement. The RMB functions as a currency for international payment, investment, trade, and reserve have been strengthened.

4. The problems of RMB circulation along Belt and Road

4.1 Complex political and economic conditions and fragile financial system along the Belt and Road

There were complex geopolitics, complicated internal religious and ethnic conflicts, and a different system of culture between countries along the Belt and Road. And the economic conditions were complicated and changeable, which is inevitably affected by the COVID-19 pandemic. Many sectors of the economy and many businesses were adversely affected. Due to these factors, increased investment and financing risks along the Belt and Road limit the scale of trade and investment. Therefore, the RMB circulation along the region through trade and investment channels has been hampered.

In addition, the financial systems of countries along the Belt and Road were relatively fragile. Most of the countries along the Belt and Road were emerging markets or developing countries with a low level of financial development and financial opening. The financial institutions in these countries were generally small in scale. Without a perfect financial infrastructure and service system, there were many obstacles to the development of cross-border RMB usage. What's worse, some countries in the region had a long-term disequilibrium of the balance of payment. Due to the high reliance on foreign capital for economic development, the debt of some countries along the Belt and Road has increased to US\$71.1 trillion in the past ten years, with a high leverage ratio of up to 219.7%. When an economic crisis happens, the large outflow of foreign capital will impact regional financial markets along the Belt and Road with increasing debt default risk. That would pose a great threat to the safety of financial assets and reduce cross-border inflows of RMB.

4.2 Strict foreign exchange controls and severe currency inertia

Most of the countries along the Belt and Road were emerging markets or developing countries with low financial opening and strict foreign exchange controls. There were 47 countries that had restrictions on cross-border capital flows, and 33 countries had foreign exchange controls to various degrees. For example, in some countries such as Mongolia, Bangladesh, Uzbekistan, etc., it was not able to use RMB as the direct currency of cross-border trade and investment settlement. Strict foreign exchange control measures limit the cross-border use of RMB.

In addition, countries along the Belt and Road have used international currencies such as the US dollar and the euro as their main settlement, denomination, and savings currency for a long time, with a perfect cross-border settlement network. For example, the main industries were oil and gas in some countries along the Belt and Road, such as the United Arab Emirates, Saudi Arabia, Qatar, Uzbekistan, Turkmenistan, Kazakhstan, etc. Most of their trade was denominated in US dollars, and their currency exchange rates have been pegged to the US dollar for a long time. Some countries, such as Timor-Leste, use the US dollar as legal tender. In the global market, commodities and foreign exchange derivatives were still mainly denominated in US dollars and euros, and RMB-denominated products were relatively scarce. So, the countries along the Belt and Road have a more strong incentive to prioritize the use of US dollars and euros over the use of other currencies (Zhou, 2021). Due to the severe currency inertia, it restricted the promotion of RMB circulation. Because of the COVID-19 pandemic, there was a severe impact on the industrial systems of countries along the Belt and Road with the terrible economic downturn. Due to the need for hedging, countries along Belt and Road would increase their financial assets of US dollar and euro instead of RMB. That would be an adverse impact on the RMB circulation along the Belt and Road.

4.3 Imperfect financial infrastructure and offshore market

China has made RMB clearing arrangements with only 8 countries along the Belt and Road. The clearing arrangements made were uneven distribution. Most of the clearing arrangements were made with the countries in Southeast Asia. There were no clearing arrangements made with the countries in South Asia and Central Asia. What's worse, most of the financial service providers were Chinese-funded banks. The level of local banks' participation was still low. Therefore, the services related to RMB circulation that could be provided were very limited. In addition, most of the Chinese-funded financial institutions in the countries along the Belt and Road were banks. There were few non-bank financial institutions such as securities, insurance, funds, and trusts. And there were few cooperation agreements in stock exchanges, futures exchanges, and gold exchanges between China and countries along the Belt and Road. Therefore, because of the lack of financial infrastructure and cooperation agreements, it was very hard to provide perfect financial products and services of RMB.

As the important platform for RMB transaction settlement and fund management, apart from offshore RMB markets in Hong Kong and Singapore, other offshore RMB markets were still in their infancy. Due to the Chinese capital market not being fully opened, the main source of RMB capital in the offshore market was cross-border RMB settlement by trade, which limits the supply and demand of the RMB capital pool. There were few RMB investment products in the offshore market. So when the investors received RMB, they would like to exchange it into major international currencies such as the US dollar or euro to invest in Financial assets denominated in US dollars or euros in the offshore market because US dollar and euro denominated products were more abundant. That would result in a lack of RMB accumulation overseas, and the investor would reduce motivation to hold and use it.

5. The path to promote RMB circulation along the Belt and Road

5.1 Strengthen financial cooperation with countries along the Belt and Road

The promotion of RMB circulation required the participation of countries along the Belt and Road. It was better for China to strengthen cooperation with other countries to reduce the barriers to RMB circulation. Firstly, China would improve the multilateral financial cooperation and coordination mechanism with countries along the Belt and Road to establish a normalized coordination organization and unified investment rules, which hold a perfect financial condition for investment and financing activities using RMB. Secondly, China would strengthen currency cooperation and expand the scale of currency swaps with countries along the Belt and Road. That would encourage countries along the Belt and Road to hold more and more RMB-denominated assets as reserves and to use RMB in trade and investment. Thirdly, China would start up pilot work of RMB circulation in border trade areas or overseas economic and trade cooperation zones along the Belt and Road, reducing restrictions on the use of RMB and foreign exchange controls.

5.2 Promoting the value scale function of RMB

Nowadays, the cross-border settlement and savings functions of RMB have been greatly developed. However, the development of the value scale function was limited. Most of the bulk commodities and financial assets are denominated in US dollars and euros, which seriously restricts the development of the RMB circulation. Therefore, it is necessary to improve the value scale function of RMB. Firstly, China could promote the value scale function of RMB through loans as there were many infrastructure construction projects in the Belt and Road every year, which increases the demand for investment and financing. With the Belt and Road Initiative, these projects could be financed by syndicated loans and bank credit, industrial investment funds, and international bonds from China. Therefore, China could change the currency proportion of the loans, increasing the share of RMB. Secondly, China could promote the value scale function of RMB through bulk commodities. The energy resources such as oil, natural gas, and minerals along the Belt and Road were abundant. China was the main major importer of energy from these countries, with the bargaining power of buyers. Therefore, it was possible for China to promote the RMB denomination of commodities with bargaining power. That was conducive to breaking the inertia of the use of dollars along the Belt and Road.

5.3 Improving the offshore RMB market

The offshore RMB market was very important for overseas RMB circulation, including overseas capital circulation, financial asset management, currency clearing and settlement, and risk management. Therefore, it is important to improve the offshore RMB market. Firstly, it is necessary to expand the supply channels of RMB capital in the offshore market. China needs to relax restrictions on the use of cross-border RMB capital, provide convenience for RMB settlement, and improve and stabilize the RMB cross-border payment mechanism. Secondly, China could improve the synergic action between the onshore market and the offshore market to promote the interconnection mechanism between the onshore market and the offshore market in financial markets such as stock markets, bond markets, wealth management, and insurance. That could improve the liquidity of RMB in the offshore market and make the RMB financial asset transactions brisker. Thirdly, it could increase the RMB-denominated financial products in the offshore market, such as the RMB bond investment products, the RMB bond index funds, green financial products, foreign exchange hedging products, asset-backed securities, and other derivative products. So, the investor could use RMB to invest in financial assets instead of exchanging RMB into other currencies, which would increase the accumulation of RMB overseas.

5.4 Improving the RMB supporting financial facilities

Supporting the RMB circulation along the Belt and Road requires perfect financial facilities. Firstly, China could increase the RMB clearing arrangements; more clearing banks need to deploy along the Belt and Road, especially in South Asia and Central Asia. Secondly, it could improve the RMB settlement network. It needs to encourage local financial institutions along the Belt and Road to participate in RMB clearing transactions and service supply. What's more, it could expand the coverage area of the CIPS system and optimize the mode of capital settlement and message receipt and delivery. Thirdly, to improve RMB financial services, it could encourage more Chinese-funded banks, securities, funds, and other financial institutions to set up overseas branches along the Belt and Road. That could provide more diversified financial services such as letters of credit, letters of guarantee, and refinancing.

6. Conclusion

In recent years, positive progress has been made in promoting the RMB circulation development of the Belt and Road Initiative. With the deepening of trade exchanges and financial market connectivity between China and countries along the Belt and Road, the cross-border settlement scale and overseas use scale of RMB has been expanded. However, due to the controls of China's cross-border capital and the imperfect financial market and economic conditions of the countries along the Belt and Road, there were still many problems with RMB circulation in this area. But it could be solved by strengthening financial cooperation, improving the RMB financial market and supporting measures. Therefore, in the future, the RMB may become one of the most popular currencies along the Belt and Road.

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