

Impact of the internationalisation of renminbi (rmb)



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Impacts of the Internationalisation of renminbi (RMB) on global economic order

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China is currently the largest goods trading nation and has the second largest economy in terms of GDP after United States (US). Goldman Sachs in 2011 stated that China could overtake US in terms of GDP as earliest as 2019. In the following essay, I will like to focus more on the positive impacts of China's currency, renminbi being internationalised and the effects on the prevailing economic order which US is leading the pack. A country's currency which has "reserve currency" status will be able to influence the global economy and politics which also in turn reflect its global strength. Since financial crisis 2009, Chinese government started to promote more eagerly and widely the internationalisation of renminbi which is currently not fully convertible yet. Internationalising the currency means renminbi will be used as a medium of exchange across China's borders and as the store of value as a reserve currency.

We must acknowledge that there will be positive impacts from the internationalisation of renminbi. Nevertheless, internationalisation of renminbi will also caused negative repercussions namely on current global economic order as spill-over effect.

One of the negative impacts is that China's exports will become less competitive and relatively less cheap as renminbi is prone to revaluation if the currency is internationalised. China's current account may deteriorate and trade surplus will decrease. Besides, liberalisation of China's capital market by internationalising the renminbi could lead to massive amount of

inflow or outflow of capitals which will destabilise the economy and being vulnerable to global speculative attacks which caused the Asian Financial Crisis 1998. Drastic and rapid financial reforms like internationalisation of renminbi could also risk the internal stability and the governing position of communist party of China (CPC) as China's local state owned enterprises (SOE) will suffer the most since they over rely on the state regulated low renminbi exchange rate, this could possibly create a downward spiral when SOEs start to lay off their workers to reduce cost.

On the other hand, renminbi being internationalised will have positive impacts on the world economy and enhance China's position in the global economic order. China could embrace the opportunity as the world largest trading nation by internationalising renminbi. Presently, renminbi is underutilised with only 0.24% world payment settled in renminbi (CNY) against its importance in world trade which China accounts 11.4%. With renminbi being more widely used in cross border trades, it facilitates more business transactions and trades with China's onshore companies and the rest of the world; this will also lead to more capital inflow and foreign direct investment from abroad which are beneficial as fund for economic growth. For example, small medium enterprises (SME) in China benefit most since they can receive better rate of loans as well as more capital to expand their business while acquiring better equipments which will induce the economic productivity in long run. Moreover, cross border trade settlement also prevent excessive foreign exchange cost and risk due to fluctuation in the foreign exchange open market. To illustrate, recently People's Bank of China had expand the clearing and settlement of renminbi payment facilities to

Frankfurt and London which promote more business transactions in Europe trading zone and more convenient to the corporations. Therefore renminbi being an international currency, could prevent China falling into middle income trap as a result of rising minimum wages, less competitive exports and less growth in productivity, by promoting the ease and convenience of investing and trading with China. This will in turn strengthened or at least maintained the position of China being one the leading power in the global economic order.

Currently, US dollar has been shaping the global economic order as the dominant reserve currency for the last three decades which account approximately 60% of total foreign exchange reserves of countries. However since the collapse of Bretton Woods System 1971, US dollar is just a fiat money which is inconvertible to commodities such as gold. Thus, US dollar is vulnerable to lose its dominant reserve currency status particularly when the people lost confidence of its value due to the huge injections of US dollar into the market by the US Federal Reserve to ease the recession which in long run it might cause hyperinflation. This incident had make renminbi as a possible alternative to US dollar as a store of value in the route to become the next world key reserve currency which provides people with more choice and liquidity.

Commodity is essential for every country's economic growth including natural resources such as steel, natural gas and petroleum which are mostly linked to US dollar. Some also refer US dollar as petrodollar since members of OPEC (Organisation of the petroleum countries) are require to trade petroleum for US dollar, this in turn create a constant demand for US dollar

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regardless of US domestic economic condition since most countries need to import petroleum and this further reinforce US dollar status as the world reserve currency. However, USA had taken the opportunity to issue more debt denominated in USD and run large budget deficit without devaluing it drastically in view of US dollar being the “ petrodollar”. Besides, US dollar tends to fluctuate more lately as the US economy is still in recession with high unemployment rate and weak domestic spending. As a result, companies and countries are force to hedge against the US dollar or even the commodity price; this in turn caused higher transaction cost for hedging purposes and also less positive economic outlook which lead to lower business investment in the future. So, actually China could exert its power as a global economic powerhouse by permitting the trade of natural resources particularly with Africa to be settled in renminbi. China’s check and balance action could benefits itself and other countries by urging US policymakers to be more sensitive with the spill-over effects caused by their decisions and also strengthening China’s position in current global economic order.

Despite, the Chinese government begun to promote vigorously the internationalisation of renminbi, currently China do not appear to possess the huge appetite to make renminbi as the next sole dominant reserve currency by replacing US dollar. Instead some experts believed that Chinese government will prefer to challenge the current global monetary system by having renminbi as one of the key reserve currencies alongside with Euro, Sterling Pound and Yen which will affect the current global economic order by strengthening the economic position of countries who are in a favourable situation due to this outcome while restraining the global economic influence

of USA. Actually if Chinese government decided to carry out this plan, they could enjoy more benefits by having multiple currencies comprising equally in the total foreign exchange reserves of countries without bearing the huge sole responsibility of being the only dominant reserve currency.

In addition, with China's lack of strong sustainable economic growth in the coming years, it is unlikely for renminbi to claim the reserve currency status easily, as a result of China's aging working population, growing income inequality among the lower middle class and the upper class, insufficient energy and food resources, rising political tension with its' neighbouring countries like Vietnam and Japan due to disputable islands. Therefore, it is more practical for China to aim to become one of the key reserve currencies instead of the sole dominant reserve currency which will automatically enhance their role in the current economic order with more bargaining power at the world stage.

In short, it is not difficult to write off the possibility of renminbi in replacing US dollar solely as the next largest global reserve currency since China having to face many challenges ahead ranging from regional political tension to China's internal social unrest. However, China's renminbi is more likely to become a international currency and also one of the key reserve currencies alongside Euro & Pound in the coming years, if the Chinese government continue to advocate the development of renminbi internationalisation with credible commitment at the expense of China having cheaper price of exports. As a result, internationalisation of renminbi will have more positive impacts on the current economic order by being the medium of exchange as a international currency which facilitate and ease the trade settlement of

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goods and commodities with more liquidity. Besides, renminbi can be used to store the value of assets as one of the world key reserve currencies and also provide alternative to the people. Thus, Internationalisation of renminbi had established China as a force to be reckoned with, in the global economic order.

(1405 words)

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