

Chinese Currency Exceptionalism: The Curious Internationalisation of the Renminbi

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Abstract

The People's Republic of China (PRC) lacks the macroeconomic conditions to internationalise its currency, the renminbi (RMB). Despite tight controls on capital markets in China, the international use of the RMB has increased significantly with the RMB becoming the fifth most used currency in global trade and financial markets. We argue that the internationalisation of the RMB has followed an unusual process, differing from the more typical features depicted in the literature on currency internationalisation. The RMB has internationalised despite the reluctance of the Chinese government to liberalise the country's current and capital accounts and its financial market. We argue that the investment role of money — overlooked or downplayed in this literature — is the main driver of RMB internationalisation. The Chinese government has created specific investment channels for non-Chinese investors that allow a controlled flow of capital to enter China's securities markets. The major players promoting the international use of the RMB are Western banks, the investment fund industry and financial services firms that have included Chinese securities in their indices. In the absence of structural conditions to expand the RMB's international use, we suggest that agents matter the most in this phase of limited RMB internationalisation.

Keywords: renminbi; China; investment; currency internationalisation

1. Introduction

The rapid growth of the economy of the People's Republic of China (PRC) in the first two decades of the Twenty-First Century and the growing Chinese economic presence internationally has drawn considerable academic and political attention to the real and potential internationalisation of its currency, the renminbi (RMB). Specifically, scholars have considered the impact of this internationalisation upon the role of the United States dollar as

the world's leading international currency. However, the RMB's rise as an international currency has consistently failed to reflect China's increased global economic presence. From late 2015, across a range of indicators, the international expansion of the RMB stalled and even moved into reverse — further suggesting that internationalisation was not inevitable (Wildau & Mitchell, 2016). Yet, during the two years prior to the start of the Covid pandemic — 2018 and 2019 — RMB internationalisation reached record levels. Despite the Covid-related economic slump of 2020 and ongoing trade tensions with the US and the European Union (EU), the RMB's internationalisation has continued. Developments since 2020 suggest that internationalisation levels will continue to rise. Thus, while RMB internationalisation has failed to reflect Chinese economic expansion, it nonetheless remains an important economic and political phenomenon of our times.

The literature on currency internationalisation places emphasis upon a number of core causal factors. Cohen (1971) emphasises the need for a current account and trade deficit, a relatively open liberalised economy, a well-developed and open national financial system, rule of law and, specifically, respect of contracts. China, at the start of the third decade of the Twenty-First Century, continued to lack or face significant deficiencies in all four of these factors. Bergsten (1997) sets five criteria for a currency to be credited 'global currency standing': the economy supporting the currency must have significant weight in world trade and production; there must be no significant external constraints on the current account; capital must enjoy full freedom of movement; financial markets should be deep and liquid; and the economy must be strong and stable. While China met at least two of these five criteria, restrictions on capital movements remained and most expert observers did not expect a sufficiently significant liberalisation of the domestic financial sector in the near future to ensure further rapid RMB internationalisation (Prasad, 2016). Yet the internationalisation of the RMB has increased markedly since 2010 —

despite the hiccough of 2016 and 2017 — and there are important signs that this internationalisation will proceed. How can we explain this apparent paradox?

In this paper we highlight a relevant factor of RMB internationalisation that has been generally ignored in the literature both on currency internationalisation and, more specifically, on RMB internationalisation: the potential importance of the investment role of money. Building on Cohen (2015), who underlines the importance of disaggregating the concept of currency internationalisation into the roles that currencies assume (see below, Table 1), we emphasise the investment role of money. We argue that RMB internationalisation, especially since 2015 has been driven by both inward investment to China and growing Chinese private sector investment abroad, resulting in investment flows from Chinese and non-Chinese financial institutions back to China. To be sure, we refer to investments — the exchange of money for the ownership of (financial) assets — as opposed to trade (settlement and invoicing, see Table 1) as the exchange in goods and services. We also demonstrate that there are a number of surprising features of this internationalisation via investment flows. We suggest that this phenomenon is due to both the growing interest of foreign investors in China's domestic financial markets and China's state-led development strategies. Chinese financial authorities created a set of investment channels to govern inward and limit outward investment flows. Investment channels and inward investment flows are important because they show how RMB internationalisation is a co-constituted process depending on both PRC government policy and the agency of foreign financial firms. While foreign financial actors are mostly driven by market-based logic — notably, demand for profitable RMB-denominated financial products — China's management of the supply side fits a broader pattern of China's currency policy — i.e., prevented revaluation. While these currency policies and investment channels were able to attract more investment, Chinese authorities exploited external pressures to help pass financial reform (Lombardi and Malkin, 2017) , which in turn enhanced the depth and liquidity

of domestic financial markets, thus attracting foreign investors' attention and generating a virtuous loop.

We emphasise the investment role of money as the key driver of RMB internationalisation: a driver that can enhance the international use of the RMB under the form of a (digital) presence in foreign investors' portfolios. This role of the RMB may continue to expand thanks to continued Chinese financial sector liberalisation and the increased attractiveness of Chinese financial markets to foreign investors. However, this role is unlikely to contribute to the RMB challenging the status-quo of the international financial system, with the US dollar maintaining its top position as a world currency. The increasing amount of RMB in speculative investment portfolios does not imply the increase of RMB use in other domains of international currency use, such as trade settlement or invoicing — both domains where the US dollar remains predominant and the euro a very distant second. Still, while the US dollar's role as world currency is not challenged — as argued convincingly by Benney and Cohen (2022) — the international use of the RMB has continued to increase. The novelty of our study, we argue, is that analysing RMB internationalisation offers the opportunity to understand currency internationalisation beyond the widespread approach of a zero sum gain struggle between states and their currencies, which builds on the idea of emerging currencies challenging the hegemonic one. Rather, currency internationalisation through the investment role of money is possible although limited by the depth of the currency's domestic financial market (inward investments) and domestic investors' ability to invest abroad (outward investments). This type of currency internationalisation — especially if based on inward investments as we show below — involves a number of Chinese and non-Chinese agents. Notably, these include the Chinese government which exerts agency through the implementation of investment channels to facilitate and control speculative investments to and from China. While focused on RMB

internationalisation, our study is of potential relevance to the internationalisation of currencies from a number of emerging market economies, which do not otherwise demonstrate the main factors that contribute to currency internationalisation.

Our analysis proceeds as follows. In the next section we examine the academic literatures on currency internationalisation and specifically on RMB internationalisation. We point to lacunae in both sets of literature. In the third section we provide an overview of the internationalisation of the RMB to date and the unusually high importance of investment finance in this internationalisation, especially since 2015. In the fourth section, we focus specifically on the mechanisms and agents of investment into China, highlighting the importance of specific channels to Chinese capital markets and the fund industry. The fifth section concludes the article.

Our analysis of RMB internationalisation is based upon a range of secondary and primary sources. The existing secondary literature includes academic work on both currency internationalisation more generally and on RMB internationalisation specifically, quality newspaper sources and other documents produced by financial firms, financial sector promotion bodies, and audit and consulting firms. Our primary sources include documentation from the China Securities Regulatory Commission (CSRC), the Chinese State Administration of Foreign Exchange (SAFE), and the People's Bank of China (PBC). We have also undertaken fifteen semi-structured interviews with bank, other financial firm and public officials with RMB-related experience and expertise. Apart from a few exceptions, the interviewees were based in Luxembourg, which is a privileged place for RMB investments as it hosts the largest cross-border investment funds and other service providers involved in RMB business, and the headquarters of EU-based Chinese commercial bank subsidiaries. An initial set of interviewees,

both senior and junior officials in their institutions, has been selected according to their roles, and contacted in person at conferences and business events in Luxembourg or via email. Others were further included thanks to a cascade-like process of identification with the help of the officials previously interviewed. Many other potential non-Luxembourg-based interviewees, experts in RMB business, were selected and contacted via LinkedIn and email, however, with the exception of only two, they did not answer. We have made use of data and descriptive statistics produced by Chinese researchers at Renmin University, the CSRC and SAFE and by the Society for Worldwide Interbank Financial Telecommunications (SWIFT) payment messaging services.

2. State of the Art: RMB internationalisation as a case study of currency internationalisation

A longstanding subject of analysis in the sub-discipline of international political economy, a number of scholars have examined currency internationalisation as a means to exercise influence over markets and other countries. The causal relationship between currency internationalisation and state power is, however, unclear — though they are strictly intertwined (Cohen, 2013, 2018). Other scholars acknowledge the relevance of internal macro-economic policies and domestic political economy developments in the issuing country to explain currency internationalisation or lack thereof (Germain & Schwartz, 2017). Scholars interested in currency internationalisation also look at changing configurations of global finance from the lens of a declining or emerging currency power. The decline of the British pound, the rise of the US dollar, the creation of the euro and more recently the emergence of the RMB are the topics most often addressed in this subfield. This section provides an overview of the main analyses of currency internationalisation in the IPE literature, the application of some of these

analyses to the study of real or potential RMB internationalisation and the contribution of our analysis to this literature.

Seminal studies by Cohen (1971), Strange (1971) and Whitman, Cooper and Solomon (1974) analyse the transforming conditions of international currencies, particularly through the lens of the British pound and the US dollar. The apparent decline of the US dollar in international financial markets with the transformation of the Bretton Woods system attracted scholars' attention. Kenen (1983), building on Cohen (1971), formalises an analytical framework to assess the role of the US dollar in the world economy and shows how the American currency maintained a dominant role despite an increasingly widespread narrative depicting its decline. Kenen outlines three fundamental functions of money: as a medium of exchange, a unit of account and as a store of value (Table 1). Governments and private actors using different forms of money at the international level constitute the determinants of currency internationalisation.

Table 1. Roles of an international currency.

<i>Levels of analysis</i>	<i>Functions of money</i>		
	<i>Medium of exchange</i>	<i>Unit of account</i>	<i>Store of value</i>
Private	FX, trade settlement	Trade invoicing	Investment
Official	Intervention	Anchor	Reserve

Source: Adapted from Kenen (1983); see also Gao and Yu (2011); Cohen (2013).

Since Kenen's contribution, other scholars have used this framework to assess potential changes in the global currency hierarchy. A number of scholars have examined the prospect of the euro substituting the US dollar as the world's major reserve currency (see, for example, Bergsten, 1997; Campanella, 2005; Chinn & Frankel, 2005; Cohen, 2003; Eichengreen, Mehl

& Chitu, 2017; Mundell, 2000; Vermeiren, 2019; and Zimmerman, 2004). Most scholars are negative in their assessment. Campanella (2005) concludes that the Euro Area lacked three of Bergsten's five criteria. For Chinn and Frankel (2005), the potential rise of the euro relied on the materialisation of two conditions: the expansion of the Euro Area to include the UK's financial markets and the decline of confidence in the US dollar as a store of value due to negative US macroeconomic developments. The increase in US dollar usage for payments through London's financial centre during the 2010s to the detriment of the euro, combined with Brexit, appears to confirm both the limited likelihood of progress of the euro as an international currency and the persistent dominance of the US dollar.

Since the international financial crisis (2007-09), a number of scholars have also questioned if the US dollar would maintain its dominant international role or if there would be a shift towards a multipolar currency system (see, for example, Bergsten, 2009, 2011; Campanella, 2014; Gao & Yu, 2011; Helleiner & Malkin, 2012). However, despite an increasingly widespread narrative depicting the decline of US power and the rise of a multipolar system, in which a rising China threatens the current international economic order, scholars and analysts have expressed caution as to the internationalisation of the RMB and scepticism as to the replacement of the dollar by the Chinese currency in the near future (see, for example, Benney & Cohen, 2022). A number of scholars have stressed the costs that China faces in attempting to increase its monetary power internationally (for example, Li, 2015; Zhang & Tao, 2014). Applying Kenen's framework to analyze the internationalisation of the RMB, Gao and Yu (2011) point to two basic conditions that China needs to satisfy in order to internationalise its currency: capital account liberalisation and full convertibility. Eichengreen and Kawai (2014) also emphasise these conditions, noting that capital account liberalisation must be supported by financial market liberalisation, exchange rate flexibility and a number of regulatory and

other developments, including central bank independence. By emphasizing the domestic dimension of currency internationalisation, Germain (2021) argues that the consideration of welfare provision would strengthen the conceptual framework for understanding currency internationalisation, and that China's current level of welfare provision is not adequate to sustain the costs of internationalizing its currency, at least not to a level capable of challenging the US dollar's dominant position.

In the early 2020s, domestic economic, social and political conditions were far from being met in the PRC. Prasad (2016) argues that — despite the significant increase in RMB internationalisation over the previous half decade — it was unlikely that the Chinese government would embark on the liberalisation, financial system development and political reform necessary to allow the RMB to replace the dollar as the world's preeminent reserve and haven currency. China's capital markets continued to face significant constraints and notably controls on the potential outflow of capital. Germain and Schwartz (2017) point to the important domestic political economy factors that discourage the Chinese government from adopting the kinds of reforms that would enable the significant increase in RMB internationalisation. Furthermore, in the early 2020s, the RMB was not yet fully convertible (McNally, 2015; Cohen, 2018; *Financial Times*, 2021). China maintained a dual-monetary system by differentiating the onshore RMB (CNY) and the offshore RMB (CNH). While the former was subject to a range of central bank interventions and constraints, the latter was 'traded outside China, under unrestricted conditions' (Subacchi, 2016: 114). The dual-monetary system operated as a safety net that allowed the Chinese government to prioritise domestic growth while decreasing the speed of capital account liberalisation, thus limiting external interference in domestic policies (cf. Lo, 2017: 102). In establishing this dual-monetary system, one of the PBC's objectives was to maintain the value of the onshore RMB

as close as possible to the offshore RMB, to better manage the central bank's monetary policy. The PBC and Chinese government feared that the opening of China's financial markets could generate room for potential speculative operations from outside the country, resulting in an increasing spread between the two RMBs and undermining the efficacy of monetary policy (Subacchi, 2016: 165). This dual-monetary system had a significant limiting effect on RMB internationalisation. The Chinese government sought full convertibility of the CNH more to meet IMF accession requirements than to increase RMB cross-border use (cf. Guo et al., 2020). However, McNally and Gruin (2017) argue that the variegated and politicised nature of capital account and currency management controls implemented by the Chinese government could still potentially allow for RMB internationalisation — and result in an era of more illiberal state-managed monetary relations.

Pacheco Pardo et al. (2019) point to PRC government efforts to create offshore RMB centres, arguing that this is a central element of its strategy to support RMB internationalisation. Although it is not the aim of their article to prove the importance of these RMB centres to RMB internationalisation — their focus is on why other countries support the establishment of RMB centres — these authors claim the significance of these centres for the development of the RMB's foreign exchange, trade settlement and investment roles. However, on the role of growing trade and RMB internationalisation, a number of scholars also point to a surprisingly limited relationship (Eichengreen et al., 2014; Tobin, 2021; Walsh, 2014). Tobin (2021: p. 1) argues 'that while offshore money markets can reduce US dollar dependence in areas such as trade invoicing that do not depend on currency delivery, increasing the offshore holdings of RMB is more challenging'. Tobin (ibid.) points to how the 'governance, geographic and credit generating limitations of [Chinese] state settlement banks reinforce the constraints imposed by the uncovered liability problem'. As another indication of the potential contribution of our

analysis, Guo et al. (2020) emphasise the critical transformation of the RMB from a settlement to an investment currency. In so doing, these authors acknowledge the traditional perspective of currency internationalisation by progressive stages: trade, investment and reserve.

A number of PRC-based researchers look upon RMB internationalisation as inherently problematic, entailing domestic liberalisation and reform, which can be perceived as undesirable costs rather than complementary benefits for China's economic development — see, for example, Gao and Yu (2011). However, there are also studies that consider the potential internationalisation of the RMB without the necessity of radical changes in market control and monetary policy in China. Hasegawa (2018), for instance, analyzes the internationalisation of the RMB as a regional currency through the lens of geopolitical frictions between China and the US in Asia (see also Kirchner 2014). Hasegawa (2018: p. 550) argues that 'the deep-seated distrust of dollar dominance and unregulated capital' in many Asian countries, will help China to regionalise the RMB in Asia. According to Hasegawa, this will happen if China continues to grow and adopts a 'moderate' diplomacy in the region, regardless of the limited access to China's capital market and state intervention on exchange rates. He thus argues that further significant internationalisation is possible — due largely to geo-political considerations in Asia — without necessarily meeting all the criteria outlined by Cohen and Bergsten.

Some scholars focus upon the potential role of trade finance in RMB internationalisation. Zucker-Marques (2021), for example, criticises the focus of most academic analyses of currency internationalisation principally on country characteristics and government policies as the main determinants, and the tendency to overlook the increasing relevance of external factors. In this vein, she argues that RMB internationalisation is not only the result of China's statecraft. The instability of global finance, including sanctions imposed on China's trade

partners, encouraged both banks and firms to search for currencies with lower transaction costs, and use the RMB as an alternative to the US dollar. However, there are crucial sectors, such as trade finance, which remain widely dominated by US dollar transactions (see SWIFT, 2021), and any RMB advancement is made to the detriment of the euro and other currencies. Recent macroeconomic and geopolitical conditions have influenced the internationalisation process of the RMB. Data released by SWIFT show that the share of world trade finance settled in RMB has grown from about 2% in February 2022 to about 4.5% in March 2023. This expansion is mostly due to US dollar and euro foreign exchange fluctuations, and a heightened presence in commercial relations, notably with Russia and Brazil. It is too early to assess if this trend will continue, or if it is a contingent adaptation to specific international conditions — to avoid sanctions limiting SWIFT services — and bilateral relations between China and Brazil. Importantly, in the second quarter of 2023, China's cross-border trade payments in RMB surpassed US dollar payments in US-China bilateral trade (Doi and Akita, 2023). In the same period, the world share of trade settlements in RMB was only 2.77%. Trade settlements represent about 25% of China's total cross-border payments, while capital transactions account for the remaining 75% (*Ibid.*), showing the relevance of the investment role of money in the RMB's international use. A more recent study by Zucker-Marques and da Silva (2022: 66) shows how 'China's policies for RMB internationalisation, in synergy with country characteristics, create an environment that enables and encourages overseas actors to adopt this currency'. With commercially close countries, the PRC government creates 'channels that allow RMB funds abroad to be recycled' (*ibid.*).

In addition to Zucker-Marques and da Silva (2022), other scholars emphasise the role of the Chinese state in RMB internationalisation. Work by Chey, Kim and Lee (2019) on policy infrastructure shows that states have a predominant and necessary role in laying the legal and

political foundations to build the networks and implement the mechanisms of currency internationalisation. Analysing the case of South Korea, Chey (2015) highlights the role of policy measures to support the use of foreign currencies, namely the RMB. Building on Cohen's (2018) concept of 'currency statecraft', Chey (2022) explains that foreign states in reaction to emerging currencies — 'reactive currency statecraft' — also have a fundamental role in facilitating or opposing the international use of currencies. Hall (2018) shows how regulatory changes in Beijing and London shaped 'a unique offshore RMB regulatory space that *enabled* RMB market making in London' (p. 262, original emphasis). Using the example of the Renminbi Qualified Foreign Institutional Investor (RQFII) scheme, she explains how the UK government modified national regulation with the specific aim to make the City of London the first Western RMB center. The strict relationship between currency statecraft and investment channels, and its effects on the spatial organisation of finance in international financial centres, is even more explicit in Hall's (2021) book on RMB market making in London. Others (notably, Chey et al., 2019) consider investment channels, RQFII in particular, as part of the wider 'policy infrastructure' that the Chinese and other states build to facilitate RMB capital flows. While we acknowledge the importance of the agency of other states / national governments in moulding the structures of currency internationalisation, we build upon this literature. Although it rightly stresses the importance of some investment channels as an outcome of policy interactions and market developments, this literature does not provide a systematic analysis of the investment role of money and does not consider actual investments and their role in shaping the internationalisation of currencies. To show how investments shape and increase the international use of the RMB, we disaggregate the conceptual framework of currency internationalisation (see Table 1) to focus on the specific investment role of money. We do so by stressing, on the one hand, the role of the Chinese state in creating and adapting progressively specific RMB investment channels and, on the other, the agency of foreign

financial service firms legitimising and facilitating foreign investments through these same channels.

In this paper, we argue that — with the exception of the above-mentioned literature that focuses only in part on Chinese investment channels — existing studies downplay the potential role of RMB-denominated investments in the internationalisation of the Chinese currency. Kenen (1983) offers the greatest detail on the investment role of an international currency, focusing on the role of the US dollar as a store of value in international financial markets, and specifically in the Eurocurrency and Eurobond markets. However, IPE analyses of both currency internationalisation more generally and RMB internationalisation more specifically focus on the real or potential contribution of other features of currency internationalisation and notably: foreign exchange (Pacheco Pardo et al., 2019; Chey and Hsu, 2020), trade invoicing (Tobin, 2021), intervention (McNally & Gruin, 2017), role as an anchor currency (Cai, 2020; Huo, 2021) and as a reserve store of value (Guo et al., 2020; Kondratov, 2021). More recently, a number of scholars have pointed to the potentially important role of digitalisation in RMB internationalisation (Lo, 2020; Loh, 2020).

To the best of our knowledge, our study offers the first systematic analysis of RMB investments to explain RMB internationalisation through the investment role of money as a fundamental, disaggregated element of the conceptual framework of currency internationalisation. We suggest that our framing of the investment role of money is particularly useful to understand RMB internationalisation and the future, potential increase of the international use of other emerging currencies. The investment role of money is not per se more important than other roles. However, this investment role explains the current phenomenon of increasing RMB international use and helps to reinforce the argument that the RMB — given China's political

economic organisation today — cannot challenge the role of the US dollar as the top world currency.

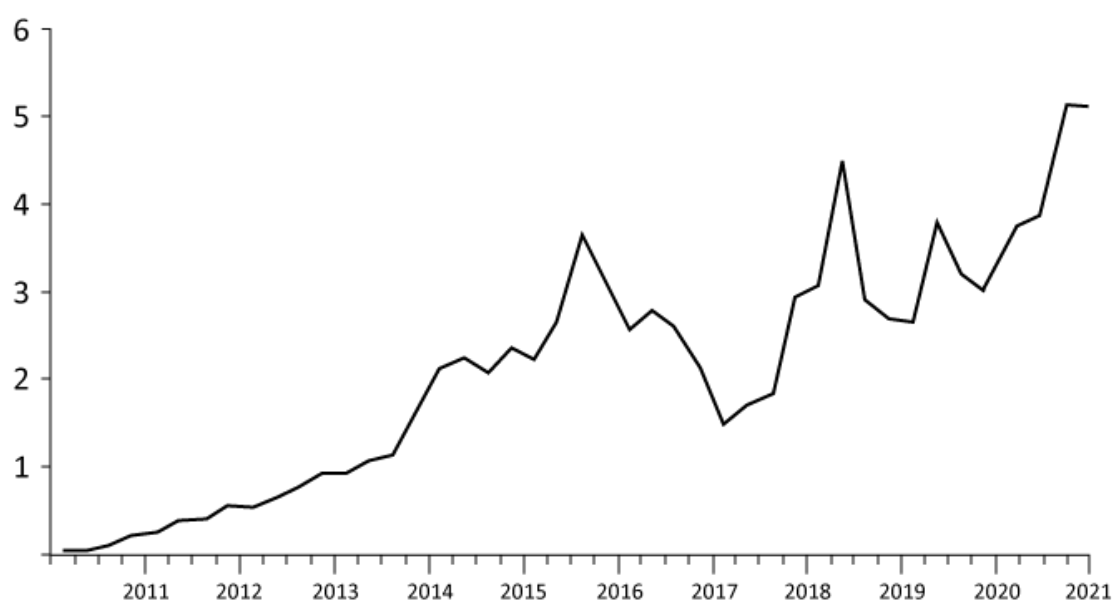
3. Internationalisation and the RMB's investment role.

The PBC and the State Administration of Foreign Exchange (SAFE) produce regularly updated official data on RMB internationalisation. According to the PBC (2021), at the end of 2020 the total amount of cross-border RMB payments and receipts by banks on behalf of their clients reached RMB 28.39 trillion — an annual increase of 44.3 per cent — demonstrating that the blocking of global value chains during the Covid-19 pandemic in 2020 did not prevent RMB internationalisation. On the contrary, there were increased investment flows into China showing that the capital account — investment — and not the current account — trade — was the main driver, at least at this stage, of RMB international use. This section corroborates this finding and explains that the PRC government's policies encouraged foreign actors to invest into domestic RMB-denominated securities as a *store of value* (see Table 1) in a period of economic and financial distress.

At the end of the first quarter of 2021, cross-border RMB settlements reached RMB 9 trillion, up 48 per cent year on year; cross-border RMB settlements under the current account grew by 17 per cent year-on-year to RMB 1.7 trillion; while cross-border RMB settlements under the capital account reached RMB 7.3 trillion, an increase of 58 per cent year on year (PBC, 2021). As an international payment currency, as of June 2022, the RMB was ranked fifth globally with a share of 2.17 per cent. According to SAFE (2021), between January and December 2020, the amount of foreign exchange settlement and sales by banks was RMB 14.1 trillion (USD 2.04 trillion) and RMB 13.02 trillion (USD 1.89 trillion) respectively. In the same period, the amount of cross-border receipts and payments by non-banking sectors reached RMB 30.33

trillion (USD 4.41 trillion) and RMB 29.55 trillion (USD 4.29 trillion) respectively. As of Q2 2021, in the International Monetary Fund's (IMF's) COFER index¹, RMB reserves were the fifth largest, with a share of 2.61 per cent, which was 1.53 percentage points higher than in 2016, the year when the RMB entered the IMF's Special Drawing Rights (SDR) basket. At the end of 2019, the RMB represented 4.3 per cent of global total foreign exchange. Renmin University in Beijing created a RMB Internationalisation Index (RII) in 2012 based on Cohen's (1971) study on currency internationalisation (International Monetary Institute [IMI], 2016; Tu et al., 2013). RMB internationalisation rose to 2016, slowed in 2016 and 2017 and then increased markedly, as shown in Figure 1.

Figure 1. RMB Internationalisation Index*



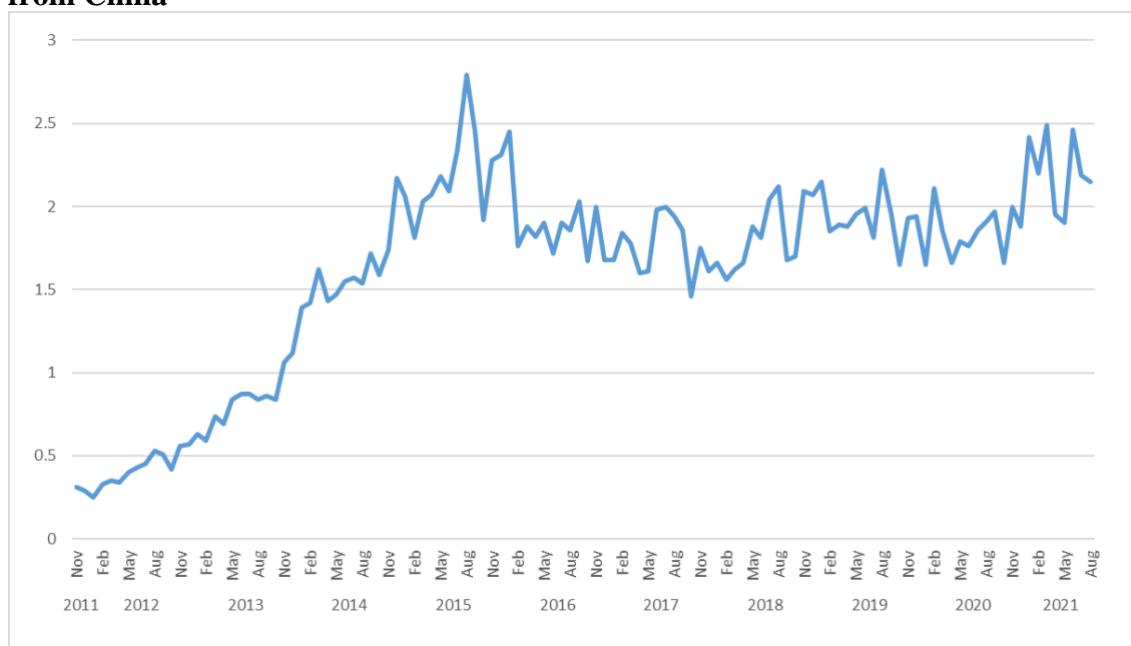
Source: IMI (2021).

*The components of the internationalisation index include the following: Proportion of settlement of RMB in world trade; Proportion of RMB overseas credit in international credit; Proportion of RMB securities in announced issues of international bonds and notes; Proportion of RMB securities in amounts outstanding of international bonds and notes; Proportion of RMB direct investment in international direct investment; Proportion of foreign exchange reserves in world reserves.

¹ IMF's Currency Composition of Official Foreign Exchange Reserves (COFER). <https://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4>

Locating precise figures for RMB-denominated cross-border payments as a percentage of total payments is challenging. However, the payments information mechanism SWIFT accounts for more than 95 per cent of all RMB-denominated cross-border payments (Interview 10). Using SWIFT data, we calculate RMB cross-border use from 2011 to April 2021 (Figure 2). Confirming Renmin University data, RMB cross-border use reached a peak in August 2015, when the RMB briefly surpassed the Japanese yen to become the fourth most used currency for international payments. In April 2021, the RMB ranked sixth after the US dollar, the euro, the pound sterling, the Japanese yen and the Canadian dollar. The RMB ranking third in cross-border trade financing, but at only 2.09 per cent of the total, while the US dollar ranked first at 88.07 per cent (SWIFT RMB Tracker, September 2021). In addition, the chart shows that after a sharp increase during the first five years of activity, the international use of the RMB experienced a significant drop from August 2015 and then fluctuating increases and decreases for a number of years.

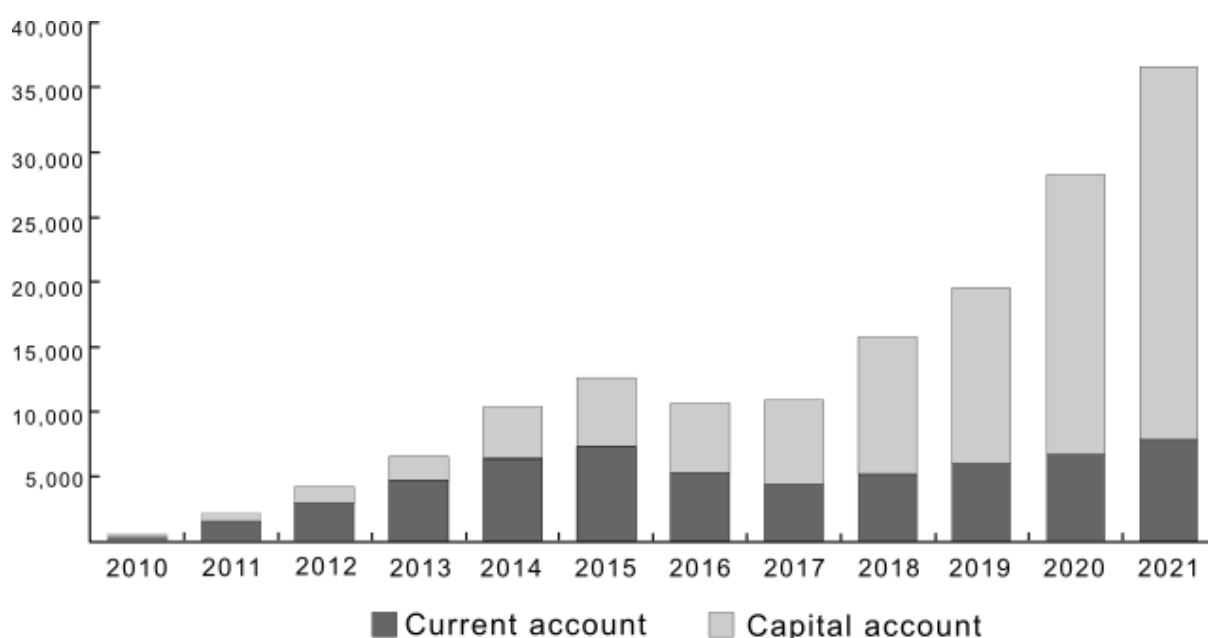
Figure 2. RMB internationalisation as a percentage of total cross-border payments to and from China



Source: Authors, elaborated from SWIFT RMB Tracker (November 2011 – August 2021).

The significant decrease in internationalisation in 2016 and 2017 did not concern all RMB activities but rather was principally due to the current account — notably trade settlement — and reflected domestic Chinese economic difficulties from the summer of 2015, with the national stock market plunging and massive capital outflows (see Figure 3). In late 2015, the Chinese central bank had to spend over US\$ 415 billion supporting the national currency (Prasad, 2016). The rapid increase of RMB internationalisation was on the capital account — which both these Renmin University and SWIFT figures fail to isolate — and the increased use of the RMB as a reserve currency notably since the IMF included the RMB in its SDR basket on 1 October 2016 (announced in November 2015; IMF, 2016). The gap between the current and capital account shown in Figure 3 increased even further in 2020 as reports from China’s State Council show (State Council of the PRC, 2021).

Figure 3. RMB Cross-border receipts and payments 2010-2021 (RMB billion)



Source: PBC

There are no precise figures on investment flows as a percentage of RMB international use. However, a number of figures combined show how investments grew significantly in importance with regard to RMB internationalisation. First, the RMB internationalisation report by the PBC (2020) shows how the total amount of cross-border RMB settlement under the securities investment item increased almost 50 per cent year-on-year, to RMB 9.51 trillion, accounting for about 70 per cent of China's capital account in 2019. Securities investments thus accounted for 48.35 per cent of total RMB cross-border use in 2019. Second, in 2019, direct investments settled in RMB reached the amount of RMB 2.78 trillion (US\$ 430 billion), or 20 per cent of the capital account, of which RMB 2.02 trillion were inward direct investments into China. Third, in 2019, cross-border funding settled in RMB amounted to RMB 95 billion or 7 per cent of China's capital account. Fourth, if we combine these figures, the total amount of RMB settlements identified as 'investments' reached RMB 13.24 trillion, or 63.7 per cent of the total RMB cross-border use in 2019. This shows how the investment item in RMB internationalisation became more relevant than transactions in the current account.

Despite the Covid-19 Pandemic and the global economic difficulties of 2020 and 2021, the increase in RMB-denominated investment flows continued apace. A number of sources attest to an investment 'boom' in RMB-denominated assets driven by a number of factors, including fear of US and EU sanctions (Loeb, 2021). However, profit was the principal motivating factor. One Italy-based portfolio manager (Interview 7) claimed that in the months following January 2020 investments into Chinese sovereign bonds 'skyrocketed' (see also BOC, 2021; Zhou, 2021). BlackRock and the Hongkong Shanghai Banking Corporation (HSBC) were two of the most active providers of services for investors in RMB-denominated assets. The increase of investments into RMB-denominated instruments owed to their being more profitable than the

same instruments denominated in the other world leading currencies. Using the example of an investment fund by BlackRock, the interviewee noted that ‘buying a 10-year Chinese bond in US dollars offered a return of about 1 per cent; buying the same security in RMB offered a return of about 5 per cent’ (Interview 7). This trend affected the overall cross-border use of RMB and worked to increase the foreign exposure to China’s domestic bond market. According to a FTSE Russell’s China Bond Report (2021), however, the overall exposure of foreign investment to China’s sovereign bond market is still limited — only 11 per cent — especially if compared to foreign exposure to the US market (26.4 per cent) and Germany (44 per cent, non-EU investors). This implies large room for market expansion potential in the future. To provide some comparative data in order to position RMB internationalisation in a wider context of cross-border financial exposure to foreign currencies, the example of the US dollar shows the limited nature of RMB international use. In 2022, the US dollar accounted for about 90% of the combined volume of FX transactions — US\$ 6.6 trillion, a 14% increase compared to pre-Covid level in 2019 (Maronoti, 2022) — a market that at the time of writing in late 2023 equals a daily turnover of US\$ 7.5 trillion. Foreign exposure to US government debt was about US\$ 7 trillion in the first quarter of 2021, while about 50% of the international debt securities are denominated in US dollars (Bertaut et al., 2021), most of which are issued outside the local market: for example, eurobonds (Maronoti, 2022). In January 2022, foreign investors held about US\$ 25 trillion of US dollar-denominated securities (Goldberg et al., 2022). There is no sign or explanation suggesting that RMB’s international investments may reach these numbers in the near future. In other words, the exposure of foreign investors to RMB-denominated securities is increasing. However, this does not mean that the RMB’s international use is increasing to the detriment of US dollar usage, nor is the RMB challenging the organisation of the US dollar-based international financial order. Despite the very limited likelihood that it will challenge the US dollar, the RMB’s international use is increasing

statistically, the main driver of which is the growth in foreign investors' exposure to RMB-denominated securities. This fact, which owes in part to the opening of investment channels to access China's domestic financial markets, is unprecedented.

4. The agents and mechanisms of investment into China: pull and push

A number of agents within and outside China and mechanisms created by the Chinese government have contributed to increased foreign investment in China and RMB-denominated investment in particular. We highlight the role of four main groups of agents, both Chinese including Chinese banks and other investors, and non-Chinese, notably the fund industry and a number of large US / Europe headquartered banks. We examine six recent Chinese government-created mechanisms to encourage foreign financial firms seeking to invest in the country and one mechanism directed at Chinese investors seeking to invest outwith the country. Finally, we examine the growing importance of foreign indices listing Chinese securities which we describe as actor-mechanisms — and their contribution to the rise of RMB-denominated debt markets.

The agents of investment

The main Chinese agents of RMB-denominated investment into the PRC have been State-owned Banks (SOBs) and private and part-private banks operating both inside and outside of Mainland China. Chinese private investors have only very recently come to play a more important — albeit still limited — role. The main non-Chinese agents have been the investment fund industry — with a particularly important role for funds managed and based in

Luxembourg — and a small number of subsidiaries of large US / European headquartered banks.

Chinese state-owned commercial banks were privileged actors to obtain RMB funding and thus promote RMB internationalisation because of their ‘offshore RMB pricing ability’ and their ability to offer ‘RMB products supported by onshore institutions’ (Interview 10). These Chinese banks were engaged in the same range of activities as foreign banks: ‘RMB settlement, RMB payment, RMB financing, RMB derivatives, intermediate of RMB investment, etc.’ (Interview 9). However, Chinese banks did not yet advertise their products outside of Mainland China. Thus, in Europe, investors contacted big European banks like HSBC, BNP Paribas, or Deutsche Bank to invest in Chinese securities. One Chinese market expert working for one of the big 4 audit / consulting firms noted: ‘This is not optimal, as Chinese banks know their market better than foreign banks’ (Interview 8). The subsidiaries of Chinese banks in Europe and the US focused their activities almost entirely upon funding the operations of Chinese companies (Interview 14).²

As for private investors based in Mainland China, their contribution to RMB internationalisation remained limited, but this too was beginning to change during the 2010s. The Chinese government retained tight control over the outflow of capital. In May 2021, the PRC government relaxed rules limiting outbound capital flows for Chinese investors, which was expected to increase RMB cross-border use in Hong Kong (Yeung, 2021) and in turn result in an increase in RMB internationalisation. The PRC government approved small but

² For example, the Chinese banks with subsidiaries in Luxembourg note in their Pillar III annual reports that most of their lending is to corporations (see, for example, Bank of China (Luxembourg) S.A. Pillar III Disclosure Report 2020, https://www.bankofchina.com/lu/en/aboutus/ab4/202106/t20210630_19667354.html; ICBC (Europe) S.A. Pillar III Disclosure Report, <http://europe.icbc.com.cn>; CCB (Europe) S.A. Pillar III Disclosure Report, <http://eu.ccb.com/europe/uploadfile/685456/20210804142235833951.pdf>).

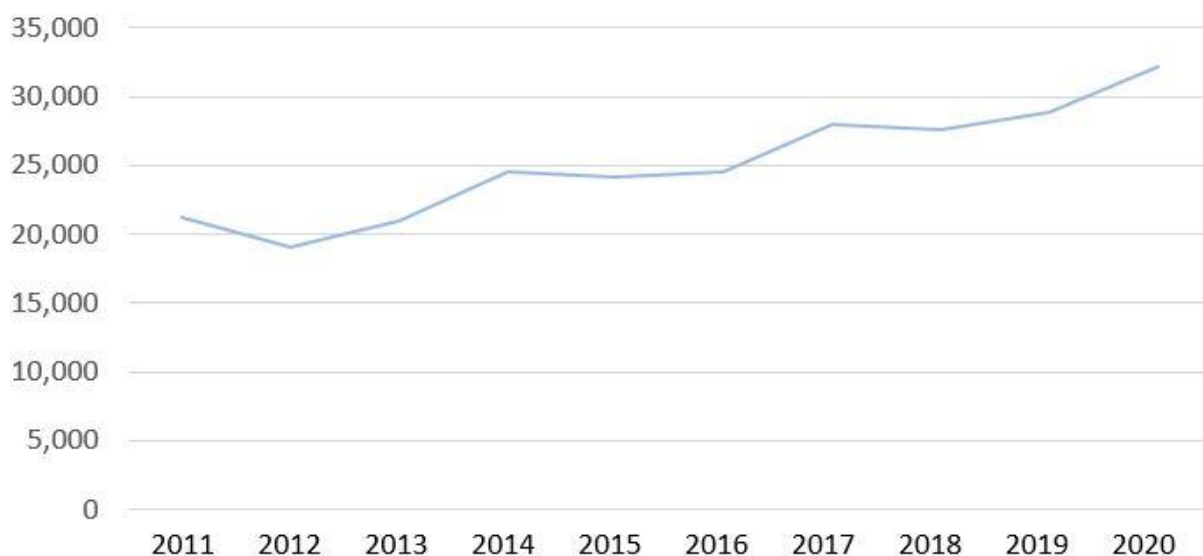
increasing amounts of investment to leave the country through the Qualified Domestic Institutional Investor (QDII) programme — a mechanism examined further below — reaching a total of US\$147 billion by the end of 2020 (Hale & Lockett, 2021). The ongoing restrictions limited the contribution of both Mainland Chinese investors and the subsidiaries of Chinese banks outside of Mainland China to RMB internationalisation.

Outside of China, the fund industry and a number of large US / Europe headquartered banks have played an important role in RMB internationalisation. Luxembourg is a key financial center for (RMB) cross-border investment thanks to its well-established cross-border fund industry (Dörry, 2015), and it has become the largest investment hub with an exposure to China's financial markets (Luxembourg for Finance, 2019). According to interviewees, 'everything is set' — that is, all the channels and the services for RMB business were in place, but Chinese banks, which had established their EU headquarters in Luxembourg, did not advertise them, thus following Chinese government policy (Interview 8; see also Balmas and Dörry, 2022). Investors interested in RMB investments continued to turn to large US and EU universal and investment banks. Both Chinese and non-Chinese bankers and other financial sector employees agreed that RMB internationalisation would take place cautiously with no unplanned initiatives by Chinese banks — 'step by step' — and that it would 'take ten to fifteen years to see real progress' (Interview 10).

The UK-headquartered bank HSBC is an important example of this growing RMB-denominated business. HSBC was confirmed for ten years in a row as the 'best overall global RMB products/services' bank by the financial affairs magazine *Asiamoney* (2021). One of its Luxembourg-based subsidiaries, HSBC Investment Funds (Luxembourg) SA, was the recognised leader in RMB business and specifically investments in RMB-denominated

securities. While only one of this HSBC subsidiary's 141 investment sub-funds — as of end July 2021 — was explicitly focused in its entirety on the RMB market (the HSBC GIF RMB Fixed Income), many of its other sub-funds invested into RMB-denominated securities, including A-shares, with a variable exposure, as the funds' prospectuses show (HSBC Global Investment Funds, 2021). A-shares are RMB-denominated equities issued in Mainland China and listed on Chinese stock exchanges. Despite the increase of RMB-denominated securities in the investors' portfolios, major operating currencies remain the euro, the US dollar, and pound sterling. Interestingly, however, HSBC Group with its operations in Hong Kong and China increased its overall RMB structural foreign exchange exposure (Figure 4). HSBC (2018: 83) noted that 'the structural foreign exchange exposures represent net investments in subsidiaries, branches and associates, the functional currencies of which are currencies other than the US dollar'. An entity's functional currency is normally that 'of the primary economic environment in which the entity operates' (HSBC, 2018: 83). In 2020, the RMB was HSBC's third functional currency, following the Hong Kong dollar and pound sterling — respectively, with an exposure of US\$ 47,623 million, 35,285 million and 32,165 million, while the euro ranked fourth with an exposure of US\$ 15,672 million. Other investment banks such as JPMorgan Chase, which opened fully-owned subsidiaries in Mainland China, must have registered similar trends in RMB structural foreign exchange exposure.

Figure 4. HSBC's RMB Structural Foreign Exchange Exposure 2011-2020 (RMB millions).



Source: Authors, elaborated from HSBC Annual Reports (2011-2020)

Financial agents such as the HSBC Group, and its Luxembourg-based investment fund, have used investment channels that the PRC government created to control inward investment flows in RMB-denominated securities issued and listed in Mainland China. To become available, these channels have needed regulatory approval in foreign financial centers (cf. Hall, 2021). In 2012, for instance, Luxembourg's financial regulator — the *Commission de Surveillance du Secteur Financier*, CSSF — signed an MoU with the China Securities Regulatory Commission (CSRC) to ease the trading of Chinese securities in Luxembourg and later the CSSF allowed investment funds to invest up to 100 per cent of their assets in RMB-denominated securities (Luxembourg for Finance, 2019).

Chinese government-created mechanisms to promote cross-border investments

The Chinese government created seven main investment mechanisms which worked to increase RMB internationalisation. Six of these were directed at foreign financial firms seeking to take advantage of the PRC government's cautious opening of the Chinese financial sector: the

Qualified Foreign Institutional Investor (QFII) and the RMB QFII (RQFII) schemes, which merged in 2020; the China Interbank Bond Market (CIBM) Direct, which rapidly became the most important mechanism for foreign investment into the PRC; Stock Connect, Bond Connect, China-Hong Kong Mutual Recognition of Funds, and Swap Connect. These mechanisms are summarised in Table 2. There is also one Chinese government mechanism directed at investors in Mainland China seeking to invest outside the country that has been potentially important to support RMB internationalisation: the PRC's Qualified Domestic Institutional Investor (QDII) scheme.

Table 2. Main channels to China's capital markets.

	QFII RQFII^a /	CIBM Direct	Stock Connect	Bond Connect	Mutual Recognition of Funds	Swap Connect
Who has access	Selected institutional investors, including smaller retail investors, and notably investment funds and asset managers	Selected large institutional investors	Hong Kong and overseas investors (Northbound trades from Hong Kong to China's mainland stock markets)	All institutional investors	Mainland China and Hong Kong-based private and retail investors	Hong Kong and overseas investors
Creation and significant reform dates	2003, 2007, 2012-13, 2016, 2019, 2020	2010, 2015, 2016	2014, 2016	2017	2015	2023
Products	All securities listed on SSE and SZSE Securities investment funds, ETFs Warrants, index futures, IPOs, FX derivatives and others	Cash bonds and other products permitted by the PBC	Selected A-shares and H-shares	All cash bonds	Investment funds	Derivatives

Currency	CNH and other FX (convert to CNY)	CNY and CNH	CNH, HKD, USD	CNY and CNH	CNY, CNH, HKD	CNH and other FX (convert to CNY)
Regulators	CSRC ^b , SAFE ^c and PBC	PBC	CSRC and SFC ^d	PBC and HKMA ^e	CSRC and SFC	CFETS ^f , SHCH ^g , OTC Clear ^h

Source: Authors, adapted from Bank of New York (BNY) Mellon (2018), LFF (2019) and Asia Securities Industry & Financial Markets Association (ASIFMA) (2021).

Notes: ^aChinese regulators unified these two channels in 2020. Today, they are both referred to as Qualified Foreign Investors (QFI). However, the distinction remains according to FX operations. QFI refers to the onshore market if the investment is in CNY transactions or offshore market if the investment is in CNH transactions.

^bChina Securities Regulatory Commission. ^cState Administration of Foreign Exchange. ^dSecurities and Future Commission. ^eHong Kong Monetary Authority. ^fChina Foreign Exchange Trade System. ^gShanghai Clearing House. ^hOTC Clearing Hong Kong.

The QFII is the oldest of these mechanisms, created in 2003 to meet the agreement on China's accession to the WTO to open progressively its domestic stock exchanges (Töpfer, 2017). This scheme was complemented from 2011 by the RMB QFIIs (RQFII), which invest directly in RMB using offshore RMB (CNH). These two schemes were then merged in September 2020. In 2003, to support the operation of the QFII scheme, the PRC government agreed to open the first offshore RMB clearing center in Hong Kong. The schemes were open to five different types of investors: asset management companies, insurance companies, security firms, commercial banks, other financial institutions such as foundations, sovereign funds and pension funds. The selection was originally based on three criteria: experience (in years of activity), net assets, and assets under management. QFII / RQFII were the main channels for smaller retail investors, and notably investment funds and asset managers (BNY Mellon, 2018). QFIIs / RQFIIs were allowed to invest in securities listed on China's National Equities Exchange and Quotations System including warrants listed on stock exchanges and fixed-income investments listed on the CIBM, as well as privately offered investment funds, financial futures, commodities futures and options. From 2012, QFIIs / RQFIIs were allowed to invest

in exchange-traded funds (ETFs) — an important and fast-growing market in Hong Kong — and derivatives (Dillon Eustace, 2014; Chin, 2022). They were also allowed to participate in bond repos, as well as margin securities lending and securities refinancing loan transactions on securities exchanges.

While the government set the cap for individual and aggregated investment, the CSRC granted the license and defined investment assets, and the SAFE granted the quotas, which were ended in September 2019. Initially, a QFII could hold up to 10 per cent of the A-shares³ in a listed company and the aggregated overseas ownership could not exceed 20 per cent. In 2012, in one of the reforms for the progressive opening of China's security markets, the latter cap was extended to 30 per cent (He, 2015). Investments suffered a period of lock-up of one year (which was lowered to three months in 2009 and then removed in 2016) and there were restrictions on the repatriation of principal and remittances. The QFII could choose a custodian from a list provided by the CSRC. The latter controlled the outflow of invested capital. After a series of reforms in 2007, 2012-13, 2016 all these restrictions were relaxed and further clarification of the rules were undertaken with the explicit aim of attracting foreign investors and strengthening the international position of the RMB (PBC, 2018a, 2018b). In September 2020, the Chinese government and the PBC announced a further reform of the QFII and RQFII schemes (CSRC, 2020). This reform unified the two investment schemes, relaxed entry requirements, eliminated restrictions on the number of entrusted intermediary institutions, reduced data submission requirements, and eased the overall process of accreditation.

³ Prior to 2003, since 1992, overseas investors could invest only in US\$-denominated B-Shares in Shanghai and HK\$-denominated B-Shares in Shenzhen.

In 2020, the largest QFIIs were the Swiss universal bank, UBS, and the US investment bank, JP Morgan Chase. To obtain a QFII license there had to be in place an agreement between the investor's home supervisory body and the CSRC. In 2020, there were 558 investors registered under the schemes, up from 250 in 2013. According to PBC (2020) statistics, by the end of 2019 just before the quota system was abolished in June 2020, 21 countries and regions were granted with RQFII quotas, for a total of RMB 1.99 trillion. 223 investors were registered under the RQFII scheme for a total of RMB 694.1 billion invested, which was about one third of the aggregated quota — which suggests that abolishing the quota system probably did not have a huge impact on the market. By the end of the first half of 2020, there were 322 foreign institutions with US\$115.98 billion of investments under the QFII scheme. Furthermore, there were 231 foreign institutions investing RMB 721.992 billion under the RQFII scheme, for an increase of 14.4 per cent compared to the end of 2019 (China Banking News [CBN], 2020).

Direct access to the CIBM was limited to large foreign institutional investors — banks, sovereign wealth funds and pension funds — while mid- and small institutional investors and retail investors needed to use other channels to access this market. Smaller retail investors only used the QFII/RQFII schemes. The CIBM Direct, created in 2010, was generally considered to be the fastest and most efficient channel to invest into China's bond market with, for example, few constraints on the repatriation of principal. As a result, the CIBM Direct was the fastest growing channel for inward investment in the late 2010s and early 2020s. As of June 2020, 796 foreign institutions entered the CIBM, with 435 doing so directly, 491 via Bond Connect, including 130 using both channels. In March 2021, total foreign holdings in the CIBM reached RMB 3.56 trillion (about US\$ 550 billion) (Economist Intelligence Unit [EIU], 2021).

The Hong Kong-Shanghai Stock Connect and Hong Kong-Shenzhen Stock Connect were launched respectively in 2014 and 2016 to funnel investments from overseas jurisdictions through Hong Kong to purchase RMB-denominated securities. The PBC allowed the use of both RMB and foreign currencies to invest through these two channels. Overseas investors using foreign currencies needed an eligible broker to conduct currency conversion with a designated settlement bank in Hong Kong. The limit to this market was, as of February 2021, defined by a daily investment quota of RMB 52 billion (about US\$ 7.66 billion) for each channel (Hong Kong Stock Exchange, 2020). This quota identified net buying of eligible stocks while selling had no restrictions. Data released by the PBC indicates that in the first half of 2020 investment via the QFII and RQFII schemes as well as the Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect schemes collectively totaled RMB 2.5 trillion, accounting for around 4 per cent of all A-share market value (CBN, 2020) — reaching US\$ 10 trillion — and nine per cent of freely circulating A-share market value (Lockett, 2020). The Chinese government also created Bond Connect as another channel to enter the CIBM. In March 2021, Bond Connect reached a transactions daily average of RMB 24.8 billion (about US\$ 3.4 billion). Complementing these four channels, the Mutual Recognition of Funds (MRF) and the Swap Connect allow Hong Kong-based investors to access China's investment fund industry and the derivatives market respectively. While the former represents a limited market which peaked in 2021 with an equivalence of about US\$ 200 million of subscriptions, the latter, established in July 2023, is expected to grow in the coming years as it provides a scheme to invest in RMB-denominated derivatives to hedge investments in China's domestic bond market. For the moment, they both represent a minor contribution to RMB internationalisation.

From early 2019, the PRC government — due in part to growing trade pressures from the US Trump Administration — moved to reform and further open domestic financial markets. The

National People's Congress fast-tracked the foreign investment law, which had been initially announced in 2015 (NDRC, 2019). This law introduced a number of important changes including: ending investment quota restrictions for QFIIs and RQFIIs; granting permission to overseas financial institutions — banks, pension companies and currency brokerage firms — to establish fully owned subsidiaries in China; removing regulation that foreign ownership of shares in domestic insurance companies could not exceed a quarter of the total; relaxing access conditions for foreign insurance companies — including the abrogation of the thirty-year operating period requirement; and granting permission to foreign institutions to conduct credit ratings in China — including all bonds on both the CIBM and the conventional market. This last development would facilitate foreign investment in the CIBM. Furthermore, the date for the elimination of restrictions on foreign shareholding in Chinese securities companies, fund management companies, future companies, and insurance companies was brought forward from 2021 to 2020. However, despite the reduction in restrictions on investment into the PRC, there remained a number of significant obstacles. For example, the range of securities available to foreign investors was limited and foreign investors were unable to switch investment channels.

From the perspective of non-Chinese investors there were two major issues of concern related to the limited 'openness' of Mainland China's securities markets and thus of relevance to RMB internationalisation. First, there remained important limits on inward investment flows through Stock Connect which had a trading daily limit of US\$ 7.66 billion (RMB 52 billion) — even though these flows never reached the cap on either total flows or quotas.⁴ Second, the PRC government ensured that the channels of investment open to foreign investors were distinctive

⁴ QFIIs had individual quota limits (a minimum of US\$ 20 million and maximum of 5 billion), with no trading daily limits. RQFIIs had no individual limitations. The quota system was abolished at the end of 2020, following which investors filing for eligibility (to SAFE) received their own quota on a case-by-case basis.

and mutually exclusive. Thus, investors who bought instruments from one channel could not sell them through another. Third, when investors placed their investments, they faced a lock-in period, which limited their ability to withdraw, thus discouraging the investment of large sums (EIU, 2019; ASIFMA, 2021). However, lock-in rules for all the channels were relaxed and removed over time. A fourth disincentive for non-Chinese investors, especially for medium and small institutional and non-institutional investors, was the limited availability of information about and lack of knowledge on Chinese securities and different practices for placing orders (Interview 8; Interview 9).

We also briefly present the one Chinese government mechanism directed at investors in Mainland China that was potentially important to support RMB internationalisation. The PRC's Qualified Domestic Institutional Investor (QDII) scheme allowed investors based in Mainland China to access assets outside Mainland China through banks and other institutions. In mid-June 2021, the PRC's government approved a record amount of investment — worth US\$ 10 billion — to leave the country (Hale & Lockett, 2021). The move reflected a number of concerns including rapidly rising asset prices in China. However, it must also be seen in terms of the Chinese government's gradual opening of the country's capital account, in support of RMB liberalisation (Hale & Lockett, 2021). This expansion of the QDII scheme complemented a number of established Hong Kong-linked programmes that allowed investment to flow out of China (Zhou, 2021). In terms of boosting RMB internationalisation, all outflows via these schemes had to eventually be converted back to RMB. The development thus highlighted the role of trade and investment finance to RMB internationalisation.

Non-Chinese Mechanisms: Foreign Indices listing Chinese Securities

Efforts to open China's security markets to foreign investment have also come from European and US financial firms which since 2017 have created foreign indices listing Chinese Securities. Since 2019, a number of major financial firms started to list Chinese securities in their indexes (Hale & Lockett, 2020; Weinland, 2019). We list the most important in Table 3.

Table 3. Major US and European Indices listing Chinese Securities

Company	Date	Index	Financial Product
Citibank Group	March 2017	Emerging Markets Government Bond Index; Asian government Bond Index; Asia Pacific Government Bond Index	Chinese government bonds
JP Morgan	March 2018	Global Aggregate Index	Chinese government and development bank bonds
Morgan Stanley Capital International (MSCI)	March 2019	MSCI Indices	Chinese A-shares (RMB-denominated stocks)
Bloomberg	April 2019	Bloomberg Barclays Global Aggregate Index (BBGA)	Chinese RMB-denominated government bonds and development bank bonds
Financial Times Stock Exchange Group	June 2019	FTSE Global Equity Index Series	Chinese A-shares
JP Morgan Chase	September 2019	Government Bond Index-Emerging Markets (GBI-EM)	Chinese government bonds
Standard & Poor's Dow Jones Indices	September 2019	S&P Emerging Broad Market Index (BMI)	A-shares mid-cap stocks
MSCI	November 2019	MSCI Indexes	Chinese A-share mid-cap stocks

Source: Authors' own compilation.

By the end of 2019, China's bond market reached RMB 99 trillion, of which the holdings of foreign investors were RMB 2.3 trillion (about US\$ 320 billion), with an increase of 26.7 per cent over the year. China's stock market reached RMB 59.3 trillion, of which RMB 2.1 trillion

was held by foreign investors, with an increase of 82 per cent over the year (PBC, 2020). By the end of 2019, the total of RMB-denominated financial assets held by overseas entities in China increased to RMB 6.41 trillion from RMB 5 trillion a year earlier (The Asian Banker & CCB, 2020). These numbers increased further throughout 2020.

Nonetheless, it is important to ask if this is a sustainable trend or just a temporary phenomenon. Indeed, at the time of writing (late 2023), the trend appears to be changing. Increased inflation between 2021 and 2022 shifted the investment behaviour of both institutional and retail investors, who reduced their exposure to fixed-income securities and their enthusiasm for Chinese RMB-denominated bonds (Interview 15). This does not mean that RMB internationalisation will face a steep slump. The definitive presence of RMB-denominated securities in US and European indexes is one of several factors that point to an ongoing increase, albeit slower, of RMB internationalisation via investment in the years to come. The recent decisions of US investment banks, notably JPMorgan Chase and Goldman Sachs, to open fully-owned subsidiaries in Mainland China to join the supply-side business, further suggests that foreign investors will have more options and increased confidence in Chinese domestic markets (CBN, 2020). There have also been a number of infrastructural developments that have worked to increase RMB cross-border business. In 2019, the London Stock Exchange (LSE) in collaboration with the Shanghai Stock Exchange (SSE) launched the London-Shanghai Stock Connect, to ease investments between the two markets. Such initiatives involving US and European indices are set to provide investors with more confidence and information when investing into Chinese domestic financial markets. Chinese state-led initiatives to facilitate and control capital flows in and out of China through the investment channels that we analysed would not be enough to guarantee the attractiveness of China's RMB-denominated securities to foreign investors. US and European indices and universal and

investment banks complement the Chinese state's agency. Even though their actions are independent and not coordinated, the agency of these indices and banks develops consequentially and to a certain extent in parallel with the development of the investment channels that grant access to China's domestic financial markets.

In this contribution, we have acknowledged, in line with the literature, the absence of broader structural factors that would allow China to internationalise its currency. For the time being, the RMB lacks what Strange (1971) defined as the economic and political circumstances that allow currencies to be used internationally. The RMB's limited, albeit increasing, international status, we argue, is mostly due to financial market and profit logics. This means that the RMB's international use, stranded between geopolitical considerations and domestic reforms, will experience a volatile progress within the limits of domestic and international structural conditions. In the absence of structural conditions that could enable the RMB to become a leading global currency, the agency of a small number of actors — and notably the PRC government, and a small number of Chinese and non-Chinese investors and banks — is the factor that matters the most in this phase of RMB contained internationalisation.

5. Conclusion

In this contribution, we have highlighted a long-neglected dimension of currency internationalisation in the IPE and economics literatures — the investment role of an international currency — in order to explain the ongoing RMB internationalisation despite the Chinese government's steadfast refusal to liberalise the country's current account — and the national economy more generally — and to relax controls on monetary policy. The country's

large current account surplus has failed to date to contribute to RMB internationalisation. IPE and economic analyses of both currency internationalisation more generally, and RMB internationalisation more specifically, have focused on the real or potential contribution of increased foreign exchange, trade invoicing, government / central bank intervention, digitalisation, a currency's anchor role in relation to other currencies and/or as a reserve store of value. We understand RMB internationalisation as a reflection of both push and pull factors that encourage the purchase and sale of RMB-denominated investments. This internationalisation has involved the PRC government, a range of Chinese and non-Chinese investors, Chinese government-created mechanisms, as well as indices created by US and European universal and investment banks and firms listing Chinese Securities.

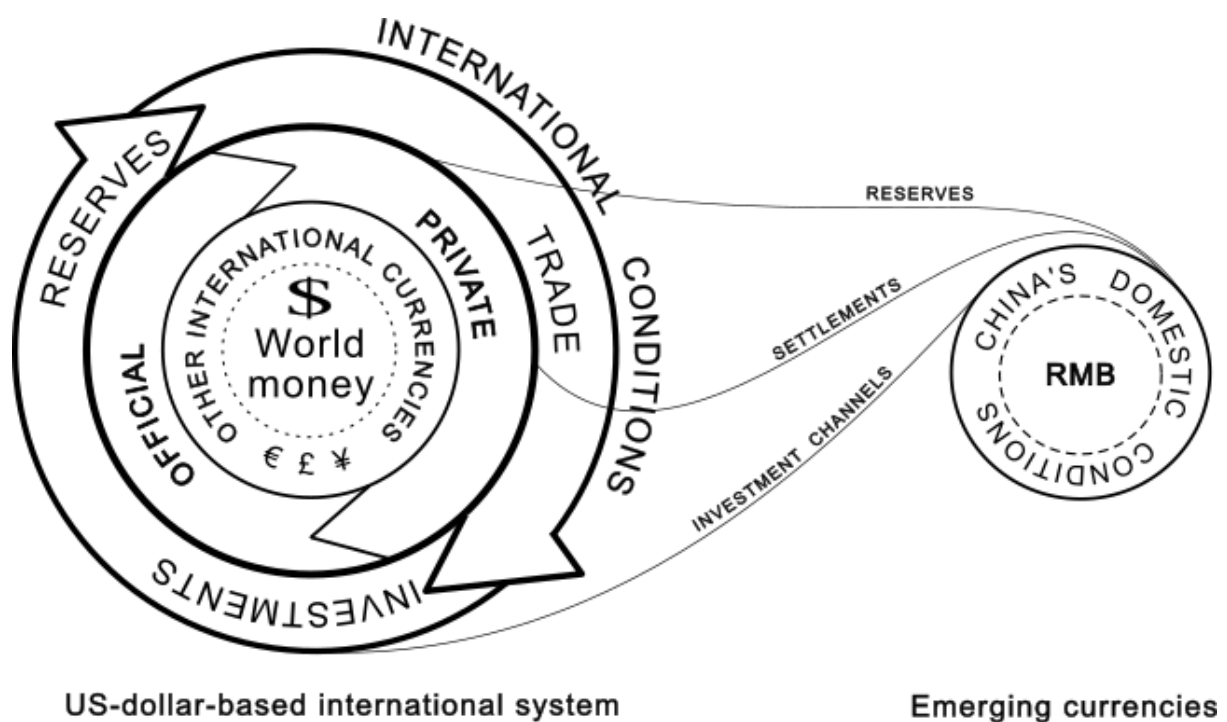
We argue that RMB internationalisation, especially since 2015, has been driven by both inward investment to China and growing Chinese private sector investment abroad — investment flows involving both Chinese and non-Chinese financial institutions but above all the latter. RMB internationalisation reflects PRC government objectives — a point highlighted by Pacheco Pardo et al. (2019) and a number of other authors. However, we recognise the importance of foreign pressure, notably coming from US administrations and from foreign investors and the reluctance of the Chinese government to accept the kinds of reforms necessary to promote RMB internationalisation. In other words, we witness the importance of agency in relation to structure in the sense that, lacking the structural conditions, the agents of RMB internationalisation matter the most in this early phase of contained RMB internationalisation. We also demonstrate that there are a number of surprising features of RMB internationalisation via investment flows. Our study shows how the slow but relentless internationalisation of the RMB results from a co-constituted process in which both Chinese and non-Chinese agents have played a relevant role. In this vein, RMB-denominated securities

have operated as a *store of value*. The investment role of money as the key driver of currency internationalisation defines China's currency 'exceptionalism'. It is true that the 'pull factors' such as investment channels were not new in China, where they have been the subject of experimentation for a relatively long period (Li, 2018). However, recent changes and the further opening of China's financial markets have marked a new phase in China's financial relations with foreign investors, and 'push factors' deserve more attention, as external forces have been downplayed in the analysis of China's financial reforms (Balmas 2019).

The novelty of our analysis lies in two different features. First, we provide, to the best of our knowledge, the first analysis of RMB investment channels to understand the role of investments in currency internationalisation. Following Cohen's (2015) suggestion, we disaggregate the conceptual framework of currency internationalisation (Table 1) to focus specifically on the investment role of money. Second, we offer an analytical approach that dismisses the common, sometimes implicit, approach of an all-or-nothing struggle between emerging currencies challenging the dominant one. Our analysis reveals that increasing the international use of the RMB does not necessarily work to the detriment of the US dollar's international use. The opening of China's domestic financial markets implies a growing number of financial instruments available to international investors. However, this increase in Chinese and RMB-denominated financial instruments does not imply a decreasing number of American or US dollar-denominated financial instruments, as it does not require a shift in settlement and invoicing services from the US dollar to the RMB. A challenge to the US dollar's international domination would involve its decreasing role in all three dimensions of the conceptual framework. By disaggregating the conceptual framework and analysing the investment role of money — the element that grew in both real and relative importance over the past decade — we show how the RMB's international use has increased despite its

incapacity to challenge the US dollar and become ‘world money’ (Germain, 2021; Benney and Cohen, 2022) — at least for the time being. Figure 5 provides a visual aid of how RMB internationalisation relates to the US dollar-based international system. In our view, the RMB’s international use as an investment currency will grow in the future, despite geopolitical and structural constraints, as China’s financial market development and opening is only at an early stage. Whether or not China, in the future, embarks on the path of challenging US dollar dominance by implementing domestic political economic reforms and enhancing other elements of state power, including military reach (cf. Cohen, 2015), remains to be seen.

Figure 5. RMB internationalisation in the context of the US dollar-based international system



Source: Authors.

While focused on the RMB, our study is of potential relevance to the internationalisation of currencies from a number of emerging market economies, which do not otherwise demonstrate

the main factors that contribute to internationalisation. With reference to the currency internationalisation framework (Table 1), the investment role of money assumes an even more important role in the actual stage of global economic development as the levels of analysis — private and official — have been converging. In other words, institutional investors such as sovereign wealth funds and pension funds are increasingly involved in investment activities beyond the traditional management of official reserves for macroeconomic purposes. This convergence can be explained as part of a process that scholars have defined as the ‘new’ state capitalism (Alami and Dixon, 2020a, 2020b). Although beyond the scope of this paper, we support further research to strengthen conceptually the currency internationalisation framework in light of the current reconfiguration of the global economy, in which both the growing presence of the state in the economy and China’s global economic expansion are two important developments. Moreover, further conceptual work on the currency internationalisation framework should be undertaken in order better to understand if a linear sequence from trade to investment and then to reserve is actually how currency internationalisation must progress. The analysis of the RMB in this article contradicts the linearity of the framework. We show that internationalisation happens through the investment role of money when trade settlement and invoicing suffer limitations from both domestic and external constraints.

More specifically, further research on RMB internationalisation is needed given the growth of total Chinese exports manufactured by Chinese-owned companies as a percentage of the country’s total exports — and thus in relation to non-Chinese firms with operations in China. The increase in these exports will be a major factor in the continued growth of RMB-denominated investment from outside China — but through a limited range of channels. Of course, interest rate differentials on RMB-denominated financial products continue to explain

a significant part of the attraction of foreign investors to these products. Large financial institutions headquartered in the US, Europe, Japan and elsewhere will — in their never-ending search for good return on investment — include increasing amounts of RMB-denominated securities in their indexes. At the same time, there remain a number of factors that will continue to limit RMB internationalisation for some time and ensure ongoing Chinese currency exceptionalism. One factor is the current absence of hedging instruments in RMB (Interview 10). A second factor is the ongoing restrictions placed on Chinese citizens to engage in cross-border investments. A third factor concerns the inadequate transparency of Chinese-owned companies. A fourth factor is the persistent importance of foreign firms in Chinese exports. While below levels of a decade ago — 41 per cent in 2007 — the foreign presence remains significant (see Ma et al., 2015). This strong presence of foreigners involved in Chinese production and export helps to explain why the use of RMB is limited in trade settlements and financing. Further research should examine if there is a clear correlation between the ownership of Chinese exports and the use of RMB in trade. The demonstration of such a clear correlation would further emphasise the role of investment in the increased internationalisation of the RMB and Chinese currency exceptionalism.

Interviews (numbered chronologically)

- Interview 1: Luxembourg diplomat, 29 October 2018, Luxembourg.
Interview 2: Luxembourg Civil Servant, 6 September 2019, by phone.
Interview 3: Fund Manager, 1 July 2019, Luxembourg.
Interview 4: Chinese Bank official, 18 October 2019, Luxembourg.
Interview 5: Chinese Bank official, 30 January 2020, Luxembourg.
Interview 6: European Bank official, 14 November 2020, Luxembourg.
Interview 7: Portfolio Manager, 26 November 2020, Rome, Italy.
Interview 8: Big Four Auditing firms official, 17 February 2021, Luxembourg.
Interview 9: Chinese Bank official, 25 February 2021, Luxembourg.
Interview 10: Chinese Bank official, 19 March 2021, Luxembourg.
Interview 11: Portfolio Manager, 21 March 2021, Rome, Italy.
Interview 12: Luxembourg civil servant, 25 June 2021, by Skype.
Interview 13: European bank official, 16 September 2021, Luxembourg.
Interview 14: European bank official, 23 September 2021, Luxembourg.
Interview 15: Portfolio Manager, 21 June 2022, by phone.

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