

# The Crypto- Renminbi

BY CHI LO

## *Challenge* To the Dollar

*Maybe not soon,  
but it's coming.*

**W**hile the Chinese renminbi is not expected to displace the U.S. dollar as the world's dominant global currency in the medium term, its creeping challenge to erode the global dominance of the dollar is certainly intensifying.

The latest challenge comes in the form of an official digital renminbi. The wake-up call of the renminbi challenge came from a message that went viral on April 30, 2020, on social media, and was picked up and reported by a few newspapers that China was set to exclude the U.S. dollar in its stock exchange transactions and that the People's Bank of China would de-link the renminbi from the U.S. dollar by stop-setting the exchange rate's daily fixing. The message claimed that the move to oust the U.S. dollar amounted to an economic war against America that would lead to a sharp fall in the dollar against the renminbi. The viral message also attributed its claims to a report by *The Guardian* on April 28, 2020, on the People's Bank of China's imminent launch of its official digital currency.

Upon fact checking and with hindsight, most of the viral message was just fake news, with no official announcement supporting the claims of ousting the U.S. dollar from Chinese stock transactions and scrapping the

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renminbi-U.S. dollar fixing, except the part on China launching an official digital renminbi. Indeed, China's digital currency move was not a surprise, as the fake news put it. China started experimenting with its official digital currency beginning in December 2019 in the technology hubs and industrial cities of Shenzhen and Suzhou. *The Guardian* report only confirmed that Beijing had added more cities (Chengdu and Xiong'an) to the experiment, which is a normal Chinese practice before any policy initiatives are rolled out on a national scale.

The digital currency move by China should also make the world nervous about a potential digital currency war between China and the United States rocking the global financial system. For China, a national digital currency could help deepen the renminbi internationalization process and challenge the prevailing international monetary order that the U.S. dollar dominates.

#### THE RISE OF A CHINESE DIGITAL CURRENCY

China has been working on creating a national digital currency since 2014, but Facebook's intention to launch a cryptocurrency, Libra, in 2019 seemed to give China a push to get ahead of the competition. The People's Bank of China launched a national digital currency in December 2019 called the Digital Currency Electronic Payment, involving the big four state banks and big three telecom companies in Shenzhen and Suzhou as pilots.

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## Xi's Currency Play

President Xi Jinping's "Chinese Dream" is intended to spread China's global influence through his Belt and Road Initiative that covers almost seventy countries and has extended more than US\$1 trillion in foreign loans since its inception in 2013. Strategically, the Belt and Road Initiative is supposed to work with the renminbi internationalization efforts in building an empire for a global renminbi. The creation of DCEP is part of this grand expansion plan, facilitating the renminbi internationalization process through the Belt and Road Initiative in the long term. In other words, Beijing hopes that launching DCEP will help boost Belt and Road and renminbi internationalization efforts simultaneously.



*Chinese President Xi Jinping*

—C. Lo

In general, cryptocurrencies have raised concerns by global regulators about their potential risks in disrupting monetary policy and financial stability and controlling money laundering, terrorist financing, and other illicit usages. But when the People's Bank of China creates the DCEP, it can see everything and anything because it is the regulator and the clearinghouse for the digital currency's transactions. Illicit usage can be better controlled, in principle. By jumping the gun in creating DCEP, China has inspired many developed-world central banks to accelerate their programs to provide digital currencies for general usage and to strengthen their regulatory oversight of cryptocurrencies. This competition is not simply on reaping the seigniorage, but about the government's ability to regulate and tax the economy globally.

From the U.S. perspective, having a cryptocurrency is also a competition with China on boosting one's dominance in the global reserve currency pool to advance the country's foreign policy claims. Just as technology has disrupted business, finance, media, and politics, a digital renminbi could disrupt America's ability to pursue its broader national interest by leveraging faith and general acceptance in the U.S. dollar. The United States certainly

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wants to defend the status quo of a dominant global U.S. dollar while China's crypto-renminbi is catching up fast to challenge that dominance.

### **CLIMBING THE GLOBAL LADDER**

President Xi Jinping's "Chinese Dream" is intended to spread China's global influence through his Belt and Road Initiative that covers almost seventy countries and has extended more than US\$1 trillion in foreign loans since its inception in 2013. Strategically, the Belt and Road Initiative is supposed to work with the renminbi internationalization efforts in building an empire for a global renminbi. The creation of DCEP is part of this grand expansion plan, facilitating the renminbi internationalization process through the Belt and Road Initiative in the long term. In other words, Beijing hopes that launching DCEP will help boost Belt and Road and renminbi internationalization efforts simultaneously.

China's incentive to climb the global ladder is indeed strong. It overtook the United States as the world's largest goods trading country in 2013, and has since been in the top two positions as the world's largest trading nation. There is a clear disconnect between the highest proportion of the world's trade going through China and that trade's denomination in U.S. dollars. The People's Bank of China even set up China's own international payments system, the China International Payment Service, in 2015 to facilitate cross-border renminbi settlements and as an attempt to break the dominance of the U.S. dollar-denominated payments system. Participants in CIPS include global banks such as HSBC, JPMorgan Chase, Citibank, BNP Paribas, and Deutsche Bank.

However, deliveries of these expansion initiatives have not been satisfactory for China. SWIFT data shows that the renminbi's share of international payments was just 1.9 percent in 2019, despite ten years of internationalization efforts. Compared to SWIFT, CIPS is much smaller, with nine hundred members as of 2018, compared to more than ten thousand in SWIFT. Furthermore, despite the International Monetary Fund's inclusion of the renminbi in its Special Drawing Right basket in October 2016, making it an official reserve currency, the renminbi's share in total global reserves has remained tiny and stagnant at under 2 percent.

To further push the international usage of the renminbi, China undertook numerous financial liberalization efforts in 2017. They included expanding the Stock Connect scheme, which links the Hong Kong stock market with the Shanghai stock market, to include the Shenzhen stock market for direct trading without foreign exchange controls, reforming the renminbi-dollar fixing

mechanism to make the renminbi-dollar exchange rate more market-driven, and establishing a Bond Connect scheme to allow direct bond trading between Hong Kong and mainland China, just to name a few.

Meanwhile, the Belt and Road Initiative aims at bolstering trade and investment between China and almost seventy countries. Under Belt and Road, China would provide large loans to fund expansion of the foreign trade network and international infrastructure

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It will be a long process.*

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projects, such as power grids, industrial parks, railways, water works, and highways. The spending of huge sums in renminbi loans and investments abroad is a way to internationalize the Chinese currency.

However, despite the push of renminbi financing, there was not much acceptance. Only 14 percent of Belt and Road trade and investment was denominated in renminbi in 2017. This creates another disconnect between China's economic prowess and the international usage of the renminbi as a funding currency. In most cases, the countries involved used only the U.S. dollar as the funding currency even though China was funding their trade and investment projects.

Despite more than a decade of internationalization efforts, and despite China's rising economic and financial clout, the slow Belt and Road development and the renminbi's small international role are certainly dissatisfactory and frustrating for the Chinese Dream. To accelerate and deepen these internationalization efforts, China needs to create a significant amount of non-trade demand for the renminbi so that it will be used as an investment and a funding currency by foreign countries. To create this secondary demand, China has to create the incentive for holding

and trading the renminbi, and for that to happen, the renminbi will have to become fungible, among other fundamental conditions.

### **CHALLENGING BUT NOT DISPLACING THE DOLLAR**

By coming in as an easily accessible exchange of value for international transactions, China's official crypto-renminbi could boost its effort to challenge the dominance of the U.S. dollar by fulfilling the fungible condition. The People's Bank of China created DCEP with the purposes of promoting renminbi internationalization in the Belt and Road policy environment, improving the convenience of renminbi cross-border payments, enhancing the renminbi as a tool for international trade settlement and invoicing, and as a store of value.

In essence, DCEP is created as part of the financial infrastructure to achieve the Chinese Dream. Arguably, the erosion of the basic functions of money (as a unit of account, a medium of exchange, and a store of value) of the G3 currencies since the global financial crisis in 2008–2009 has opened up a window of opportunity for the renminbi to rise to challenge the world monetary order, as I have argued elsewhere. And Facebook's intention to launch Libra just gave China a push to jump the

gun, as there is a risk that Libra may threaten China's internationalization efforts.

Even in the medium term, the rise of a Chinese digital currency is not going to undermine U.S. dollar dominance of global trade and finance, at least the large part that is legal, regulated, and taxed. America's rule of law lies at the core of its deep and liquid capital markets and strong institutions. These values will continue to trump China's efforts to achieve any financial dominance until China is able to build a system that commands international credibility and confidence. The fact that despite China's rising economic clout there is still so little acceptance of the renminbi by the international community speaks volumes about the technical and economic obstacles behind the currency.

China will have to sort out the renminbi convertibility issue first before it can push its internationalization ambition further. It will be a long process for it to sort out its market distortions due to capital controls, lack of transparency, governance problems, and restrictions on foreign ownership of Chinese assets before the renminbi could displace the dollar as the premier global currency. But the DCEP's challenge to the dollar's dominance is real and intensifying, as it may serve as a catalyst for prompting changes in China. ◆