

Opportunities and Challenges of RMB Internationalization in the Context of COVID-19

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Abstract

The sudden COVID-19 in 2020 will have a greater impact on global economic development and financial market stability. Since March, the Fed has cut interest rates several times in a short period of time and opened an "unlimited" quantitative easing monetary policy in response to the COVID-19 shock. This measure has the function of stabilizing the financial market in the short term and supporting the macroeconomic recovery, but in the long run, it will bring many adverse effects on the world economy and continue to have side effects on the stability of the world's financial market. But this move also brings new opportunities for the process of RMB internationalization. This article will analyze the three rounds of quantitative easing of the Federal Reserve after the 2008 subprime mortgage crisis, analyze the promotion effect of this quantitative easing on the internationalization of RMB, and give the opportunities and challenges faced by RMB internationalization in the context of COVID-19, and propose policy suggestion.

Keywords

COVID-19; RMB internationalization; quantitative easing.

1. COVID-19

COVID-19 is the most significant public health emergency response since the founding of New China. Its rapid spread, wide range, and difficulty in prevention and control make it very difficult to control the epidemic. In the process of epidemic prevention and control, China and the world have paid a huge price. The economic operation of various countries has basically deviated from the original normal track and even entered a state of almost "shut down"; various industries have stopped working and production has stopped, and global trade activities have also almost stopped.

COVID-19 initially broke out from Wuhan, China, and then spread to developed economies represented by Europe and the United States. In April, emerging market economies represented by Brazil, India, Russia, and Mexico also entered a period of rapid outbreaks. Professionals said that the development of the epidemic in various countries is closely related to the degree of development of various economies, the mobility, and the density of the population. At present, my country's epidemic situation has been well controlled, and it will enter the "normalization" epidemic prevention and control stage in the future. New cases in Southeast Asia also entered the platform period, and new cases in Europe also entered a declining period. The current high point of the global epidemic situation is in the United States. As of June 21, 2020, a total of 2330578 cases of new coronavirus pneumonia were diagnosed in the United States and a total of 121980 cases of deaths. It entered a high platform period, and the rate of new cases declined slowly.

2. The Process of RMB Internationalization

The process of RMB internationalization started in 2009 and has experienced ten years of ups and downs. With the continuous implementation of domestic policies and the gradual and continuous development from the point of view, the opening of the inter-bank bond market to foreign banks, the opening of the "Shanghai-Hong Kong Stock Connect", the "8.11" exchange rate reform and other important measures have been launched, and the pace of RMB internationalization has maintained Move forward steadily. As of the end of 2018, the RMB has become the world's fifth-largest payment currency, the eighth largest foreign exchange transaction currency, the third-largest trade financing currency, and the sixth-largest reserve currency.

2.1. Cross-border Trade Payment Settlement

In July 2009, the six ministries and commissions issued the "Administrative Measures for Pilot Settlement of RMB Settlement in Cross-border Trade", marking the official start of the process of RMB internationalization. At that time, after the subprime mortgage crisis, the United States, as the center of the subprime mortgage crisis, was the hardest hit and spread to the world. The frustration of the US economy has led to a liquidity shortage in the entire international monetary system. In the global economic trade payment settlement process, new currencies are needed to replace the US dollar, especially for emerging economies with rapid economic growth. Some economies offered to reach an exchange agreement with China, and my country used this as an opportunity to start the process of RMB internationalization.

Over the past ten years, RMB cross-border trade settlement volume has grown steadily. The total scale of the settlement of RMB business in cross-border trade increased from 506.3 billion yuan in 2010 to 6.04 trillion yuan in 2019, with a compound annual growth rate of 31.71%.

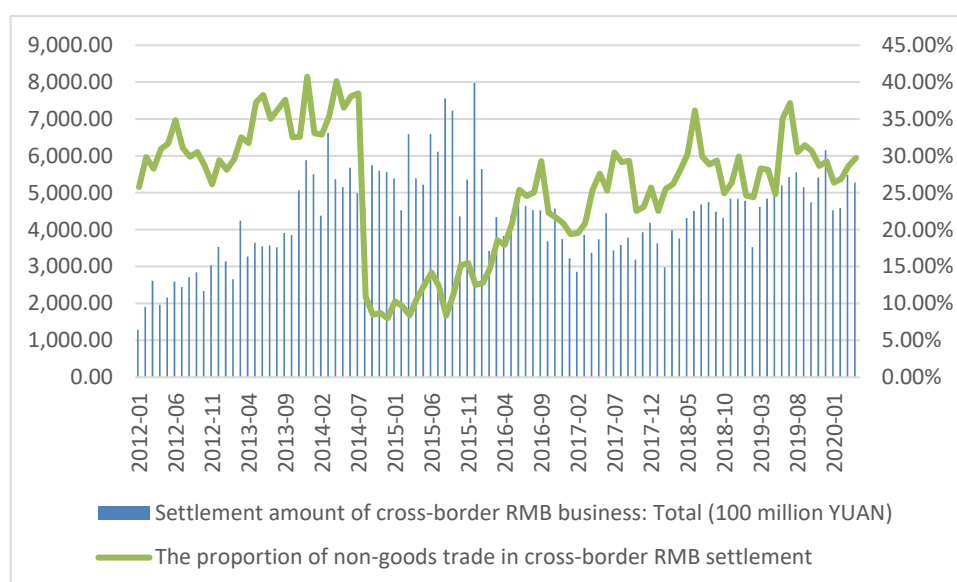


Figure 1: RMB settlement amount of cross-border trade

Source: wind

2.2. The Renminbi Investment and Financing Attributes Appear

After the renminbi settlement measures for cross-border trade business achieved initial results, the central bank began to gradually liberalize capital account control, accompanied by a series of QFII, QDII, Shanghai-London Connect, Shanghai-Hong Kong Stock Connect and other measures to open and gradually "loose", while actively promoting RMB assets Incorporating

international indexes such as MSCI, FTSE Russell and S&P Dow Jones Indices, RMB internationalization has entered a new stage.

At this stage, thanks to the loosening of policies, the investment and financing properties of RMB have become apparent, and the attractiveness of RMB assets has also increased significantly. As the absolute rate of return on RMB assets is higher than most countries, including developed countries, domestic financial supporting facilities have also gradually improved, the derivatives market has gradually developed, foreign capital has poured in, and market activity has also increased rapidly.

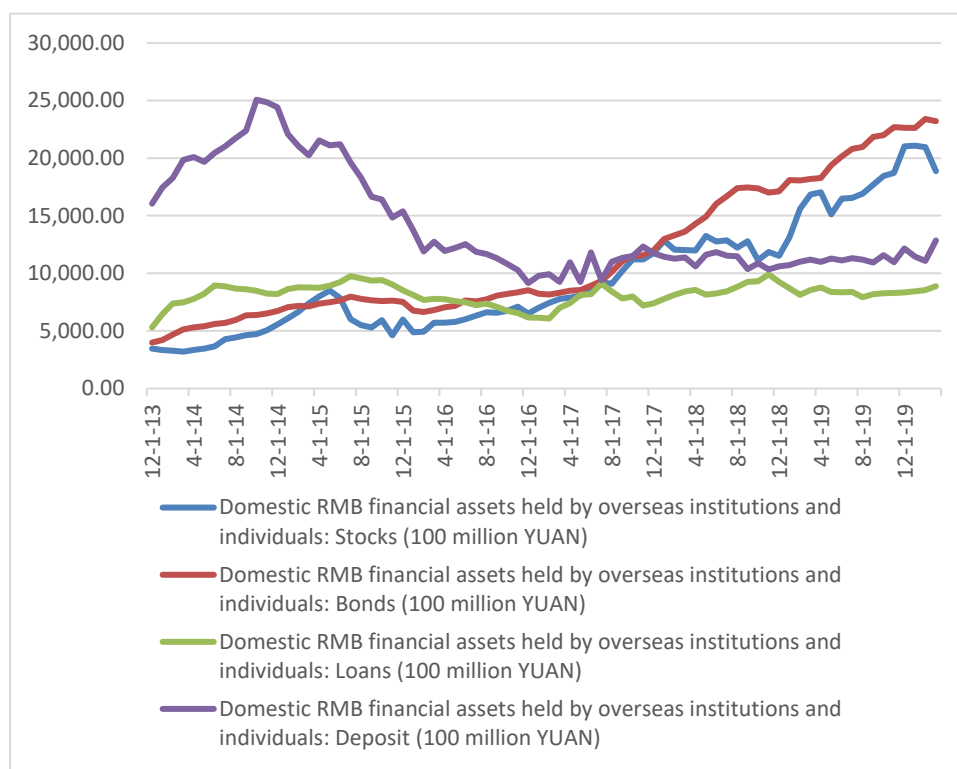


Figure 2: Scale of RMB assets held by foreign investors
Source: wind

2.3. Enter the "International Currency"

On December 1, 2015, the IMF officially announced that the RMB will be included in the SDR currency basket. This is the first step for the RMB to make a reserve currency, marking a major step forward in the process of RMB internationalization.

However, we should also clearly realize that although the renminbi internationalization process has achieved great results, the renminbi's international status is still far from international currencies such as the US dollar, British pound, and Euro. We can see that despite the tremendous impact of the 2008 subprime mortgage crisis on the United States, the US dollar is still the number one international currency. In the face of the constant challenges of the euro, the gap between the two is widening. Therefore, the entry of RMB into the "international currency" will be long and difficult in the future.

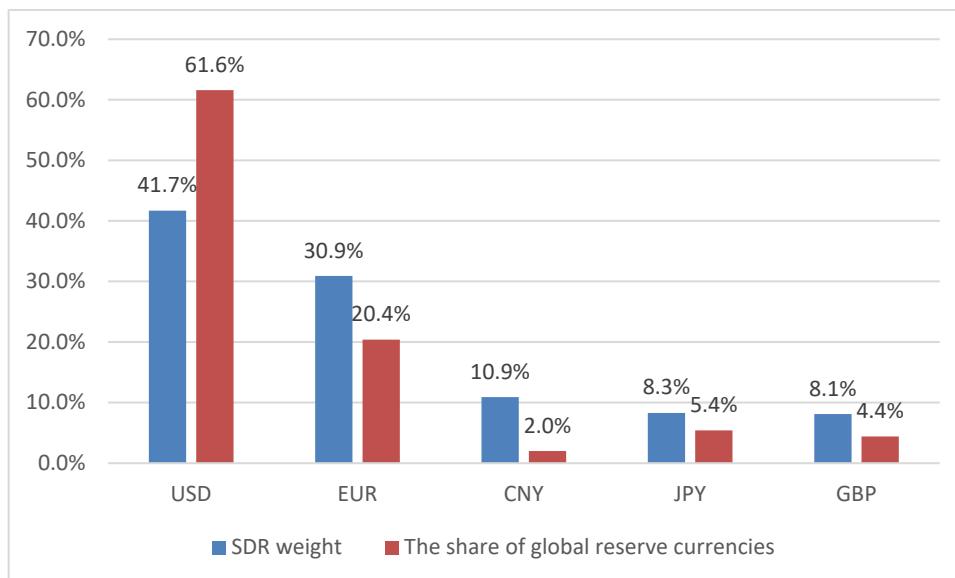


Figure 3: The share of reserve currencies in the SDR currency basket
Source: IMF

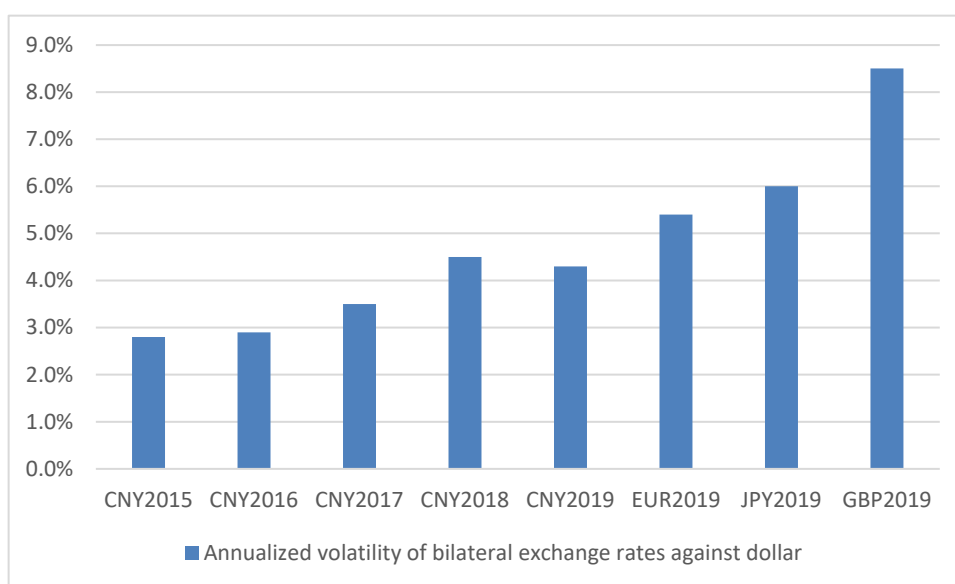


Figure 4: Comparison of exchange rate elasticity among countries
Source: IMF

3. Challenges Faced by RMB Internationalization in the Context of COVID-19

The negative impact of COVID-19 on the world economy and development far exceeds expectations, and it is currently unpredictable how much impact it will actually have on the world economy. In the "World Economic Outlook (WEO)" released by the International Monetary Fund (IMF) on April 14, 2020, it had lowered its previous expectations for the global economic growth of 3.3% in 2020. The IMF combines the latest epidemic development trends and believes that the global economy may experience a negative growth of -3% in 2020.

While COVID-19 has caused such a great impact on the world economy, it will also have an inhibitory effect on the process of RMB internationalization. It can be said that COVID-19 is changing the current international landscape and will have an adverse impact on the process of RMB internationalization from both domestic and international aspects.

First of all, although China under the epidemic situation has begun to steadily resume work and production, residents' consumption is still greatly suppressed. Due to risk aversion, industrial investment has also been greatly suppressed. The most affected is China's exports. Affected by the epidemic, the economic operations of various countries have basically deviated from the original normal track, and even entered a state of almost "shutdown"; various industries have stopped production and production, and global trade activities have also almost stopped. Greatly affected. Under the influence of the epidemic, the consumption, investment and exports of the "three carriages" that promote economic growth have been suppressed to varying degrees. Under such a background, can China survive the "bottom period"? Can the economy achieve stable growth? Will there be systemic financial risks under economic turmoil? Under the tense external environment, can we further steadily advance the process of RMB internationalization and achieve a higher level of opening up? These are issues that we need to focus on.

Internationally, the rapid spread of COVID-19 in the United States and repetition around the world may continue to have an impact on the world economy. In the short term, it is not possible to predict when the epidemic may be alleviated, or whether the final impact of COVID-19 on the world economy can be controlled within an acceptable range. In particular, there is the "unstable factor" of the United States, which threatens world security from a policy and political level. It is not known whether the United States will take some unreasonable measures to prevent the process of RMB internationalization in this situation. In short, the process of RMB internationalization still faces many challenges.

4. Opportunities for RMB Internationalization

RMB internationalization is a process, and it is a long-term and full of obstacles. The competition between currencies is actually a manifestation of economic competition among countries. A currency becoming an international currency involves redistribution of mint taxes on a global scale. It needs to break through obstacles such as international currency conversion costs and inherent foreign exchange risks. Many scholars in the West have deeply researched and analyzed the process of international currency competition and came to the conclusion that countries have inertia when choosing to use the international currency, and the conversion of the current international currency to other international currencies requires considerable conversion costs. Therefore, unless the current international currency is in crisis or suffered a large external shock, it will consider the conversion of international currency. The renminbi, as an emerging currency, is bound to encounter greater obstacles in the process of becoming an international currency. Therefore, the conversion of international currencies is not just a matter of time, but needs to be harmonious at the right time.

RMB internationalization experienced five years of rapid development from 2009 to 2014. In fact, it was also a period when the US dollar was relatively weak. At that time, in order to recover the economy as quickly as possible under the influence of the subprime mortgage crisis, the Fed launched three rounds of quantitative easing monetary policy for six years, and it did not begin to gradually withdraw until the second half of 2015. During this period, the dollar index was sluggish and the dollar was in a relatively weak period. The rapid progress of RMB internationalization needs to be attributed to the weak performance of the US dollar to a certain extent, and the continuous double surplus of my country's international balance of payments in those years made the RMB continue to appreciate.

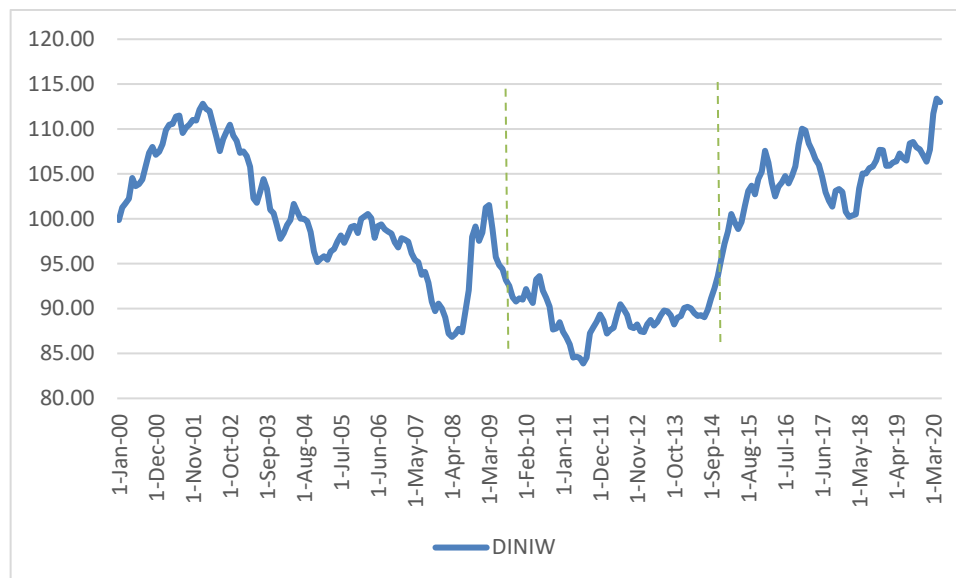


Figure 5: Trend of the US dollar index from 2000 to 2020

Source: wind

With regard to the series of effects of the previous quantitative easing policy before the bid, this “uncapped” quantitative easing policy is very likely to lead to the continued weakness of the US dollar in the next few years. This is a rare opportunity for RMB internationalization. The Fed has cut interest rates twice in a row, and after the interest rate has dropped to zero interest rates, it has restarted its quantitative easing policy. Unlike the previous quantitative easing, the keyword “unlimited amount” of this policy shows that the United States has used its utmost to save the market. Although the liquidity crisis in the United States can be saved in the short term, the impact on the world economy in the long run is incalculable. The international status of the US dollar will also be affected to a certain extent. In recent years, with the support of a series of policies issued by my country, the RMB has become increasingly active in international trade settlement. The current downturn in the US dollar is an opportunity for RMB internationalization.

As China performed well during the COVID-19 period, it has given many material and technical assistance to countries around the world, demonstrated its role as a major power, and has improved its image and status in the world, helping China in the world financial market. Acquiring more participation and voice in the system is also conducive to further advancing RMB internationalization.

In recent years, China has been vigorously promoting the “Belt and Road” development strategy, which on the one hand enhances the RMB’s international settlement capability and on the other hand enhances the RMB’s ability to store value. At the same time, because the “Belt and Road” strategy is a long-term and huge project, it will inevitably require a large amount of financial support during the construction process. The huge financing needs and investment needs have also brought more opportunities for Chinese enterprises and funds to “go out”. Many opportunities also played a great role in promoting the process of RMB internationalization.

The epidemic has a great impact on the world economy. Not only has the United States launched quantitative easing monetary policy, countries have begun to lower interest rates in order to stimulate the economy, and the bond yields of various countries have continuously hit new lows. The stock market is also constantly fluctuated by the impact of uncertain expectations. Compared with other countries, China’s bond yield has always been at a relatively high level. Although it has recently hit a new low and entered the “debt market winter”, the yield is still higher than some countries represented by the United States. In the next few years or even a

longer period, it will continue to exist. In the stock market, due to the earlier effective control of the impact of the epidemic in my country, the impact of the epidemic on the economy has been minimized. All industries have resumed production in an orderly manner since March, and basically completed all production resumption in June. Although the economy has been affected by a considerable amount, the uncertainty of future expectations is still smaller than that of other countries, so my country's stock market will be relatively stable for a period of time in the future.

The high yield of the bond market and the stable investment value of the stock market must attract a large amount of foreign capital inflows. With the opening of many foreign capital inflow channels in China's policies, it is expected that China may experience a peak period of foreign capital inflows in the future. The substantial increase in RMB assets held by foreign investors will promote the further internationalization of the RMB.

5. Suggestion

The index that truly reflects the international competitiveness of a country's currency is the status of the currency in the global reserve currency. The US dollar accounts for more than 60% of the global reserve currency, marking its unshakable dominant position. What determines the status of a country's reserve currency is the breadth, depth, and liquidity of a country's financial market, that is, whether a country's financial market has a large enough scale, sufficient financial products, and sufficient liquidity, only to meet these conditions, the monetary authority is willing to exchange reserve currency for that currency. Objectively speaking, from these dimensions, my country's financial market is still far behind the United States.

5.1. Continue to Accelerate the Reform of Interest Rate, Exchange Rate Marketization and Capital Account Opening

Whether a currency can become an international currency is actually the result of market selection, and it is the optimal resource allocation that the market chooses. The biggest obstacle for my country's current RMB internationalization is that it has not yet fully realized the marketization of interest rates and exchange rates. Only when the market plays a decisive role in the allocation of resources can the power of the market be truly manifested and the independence of monetary policy can be manifested. This is the basis for becoming a national currency and becoming an international currency. On the other hand, the capital account has not yet been fully opened. One of the characteristics of international currencies is the convenience of their conversion and transactions. This convenience is not only reflected in trade activities, but also in capital flows. The convenience of capital flow depends on the degree of capital account opening of a country. Only when the capital account is gradually liberalized can foreign financial institution investors and individual investors and the authorities be able to enter the Chinese financial market smoothly and at low cost, and the road of RMB internationalization can be smoother and smoother.

5.2. Focus on Financial Infrastructure Construction and Vigorously Develop New Varieties

Financial stability is the basis and premise for a country's currency to be trusted and circulated around the world. China has vigorously developed finance in the past few decades and achieved great results, but there are still many deficiencies in financial supervision and the construction of laws and regulations, which need to be continuously improved and strengthened.

On the other hand, the richness of financial market products is also an important condition for attracting foreign capital inflows. At present, COVID-19 has a great impact on the global economy, and a large amount of risk aversion has accumulated. At this time, vigorously

developing the derivatives market and launching more flexible and effective hedging financial products are important opportunities to increase the activity of the domestic financial market and attract foreign investment.

5.3. Further Strengthen International Financial Cooperation and Exchanges

Although RMB internationalization is ultimately the result of market selection, it does not mean that the government cannot play its due role. The government should continue to strengthen international economic exchanges and cooperation, create good economic and financial conditions for the internationalization of the renminbi, and continuously enhance my country's participation and voice in the international financial market, which is of great significance to the internationalization of the renminbi.

Relying on the good foundation of the "Belt and Road" initiative, we can further deepen the mutually beneficial and friendly cooperation in economy and finance with the countries along the route. Relying on the good foundation of the "Belt and Road" initiative, we can further deepen the mutually beneficial and friendly cooperation in economy and finance with the countries along the route. Accelerate the pace of "going out" of financial institutions, and lower the threshold for foreign financial institutions to "walk in", realize the complementary advantages of domestic and foreign financial institutions, deepen the business transactions of domestic and foreign financial institutions, improve cooperation capabilities, and ultimately achieve a high level of financial service quality.

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