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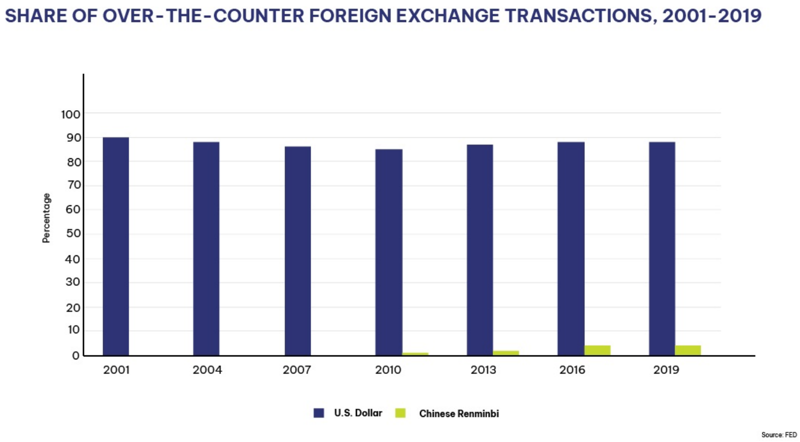


U.S. Dollar to Remain Dominant Despite RMB Internationalization

In recent months, a growing **chorus** **of** **analysts** has argued that the U.S. dollar's dominance is waning, with China's renminbi (RMB) emerging as the leading replacement.

Other **analysts**, however, take a more circumspect view. They concede that some countries are moving to use currencies other than the USD for trade and reserves purposes, but doubt that the RMB will systemically replace the dollar anytime in the foreseeable future. The Asia Group assesses that most evidence supports this view.

China and Russia are clearly motivated to ramp up RMB **use** to settle trade transactions because of the U.S.-led sanctions against Moscow. Those sanctions have frozen much of Russia's foreign currency reserves and removed major Russian banks from SWIFT, which facilitates most international banking transactions.

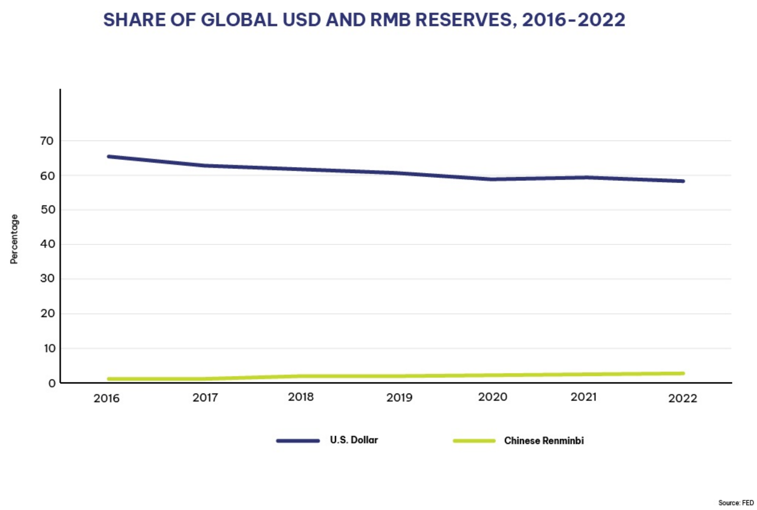
In other examples, Bangladesh will **pay** Russia some USD 300 million in RMB to settle payment for a nuclear power plant. Countries like **Brazil**, **India**, **Saudi Arabia**, and **Kazakhstan** have all taken steps to trade in currencies other than USD. The RMB is, in fact, already the **dominant** currency in Brazil's foreign reserves, and Brazilian President Luiz Inacio Lula da Silva has called for a BRICS currency to reduce his country's reliance on the U.S. dollar. Officials from Southeast Asian countries including Indonesia have **made** similar arguments – not only about reducing dependence on the U.S. dollar, but also on the Japanese yen and the Euro.

These developments are real. Many countries will continue looking to reduce their reliance on the U.S. dollar, seeing risk in Washington's ability to cut them off from the world's dominant financial system – as the United States has **done** with Russia.

But the fact that more world *trade* in goods and services will be settled in RMB, the Indian rupee, or the Saudi riyal does not mean that the USD will lose its status as the world's dominant currency for *financial and trade* transactions.

The USD still dominates cross-border trade. More important, however, is the fact that the dollar was **used** for 88 percent of foreign exchange market transactions in 2022 – roughly the same same level as **throughout** the 2000s and 2010s. The RMB was used for a mere seven percent of foreign exchange market transactions in 2022, up from four percent in 2019.

The RMB has also not yet proven itself as an attractive reserve currency. Despite Beijing's desires, the RMB's **share** of global reserve assets is less than four percent; the USD still **holds** about a 60 percent share.



Moreover, China's government has undermined the RMB's internationalization by maintaining strict control of the exchange rate, rather than allowing the market to determine the rate in line with international norms. China's capital controls, which Beijing seems unwilling to abandon, have also prevented the world from gaining access to sufficiently large quantities of RMB-denominated assets to use them as reserves and collateral – prerequisites for the RMB to become a leading international currency.

In addition, China's relatively underdeveloped financial markets undermine foreigners' willingness to use the RMB. And unless China reduces its high domestic savings rate and large account surplus, Beijing will keep accumulating reserves in foreign currencies like USD, diluting its RMB holdings.

Ultimately, a currency needs to do three things to become a favored global currency: (1) maintain its value (on the open market); (2) move freely across borders; and (3) be widely-accepted. China's RMB currently falls short on all three.

Some countries may ramp up use of China's currency for reserve or trade purposes. Some will do the same with other non-USD currencies, like the Indian rupee and Saudi riyal. But none of these currencies are close to replacing the USD, despite political leaders' promises to internationalize them. A potential BRICS currency, as suggested by Brazilian leader Lula, is not likely to exist or play a USD-like role either, given China and India's focus on their own interests and political tensions between them.

The most likely near-to-medium term result will be some limited fragmentation of the global financial system, particularly in the developing world, which may lead to a gradual drift toward wider use of non-USD currencies for trade transactions. But on the whole, the USD will continue to dominate the global system – despite the rhetoric coming out of Beijing, Riyadh, and, at times, New Delhi.

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