

Russia Gives China's Yuan a Boost as Firms Cope With Sanctions

- Western sanctions on Russia are bolstering demand for yuan
- Export strength means more receipts are being settled in yuan



Bundles of Chinese yuan banknotes. *Photographer: Toru Hanai/Bloomberg*

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As Xi Jinping and Vladimir Putin prepare for a likely meeting this week to cement China-Russia relations, one area where stronger economic ties are already being seen is on

the currency front.

China's yuan is proving to be a useful release valve for Russian companies hemmed in by sanctions that prevent them trading in dollars. Russian businesses are using yuan to settle more of their trade and are boosting borrowing in the Chinese currency. Moscow is also increasing holdings of yuan in its foreign-exchange reserves.

Trade Boom

China's purchases from Russia hit new record last month

Source: China's General Administration of Customs

While the overall amounts are modest and Russia has described its pickup in demand for yuan as temporary, the development is adding to greater use of the Chinese currency in the global economy, coming on the back of a years long export boom. Russia's increased use of the yuan could also serve as a template for other Chinese trading partners looking to gradually reduce their reliance on the dollar, which dominates global trade.

“I wouldn't be surprised to see a further increase in yuan usage,” said Hui Feng, a senior lecturer at Griffith University in Queensland, Australia and co-author of ‘The Rise of the People's Bank of China.’ “The fundamental factor here is that China's trade surplus will

remain high this year. On top of this is the Russia factor.”

Russia-China trade has soared since the invasion of Ukraine in February. China is buying more oil than ever before from Russia, while its exports to Russia are growing at a double-digit pace even as shipments to many other places slow down.

In August, China’s ambassador to Russia, Zhang Hanhui, said the two countries should step up coordination to resolve difficulties in trade settlement brought about by Western sanctions on Russia. China will continue to support using more local currency settlement in bilateral trade, Zhang said in an interview with Russian media.

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More of those transactions are already being settled in yuan. State-run gas giant Gazprom PJSC said it will shift its contract to supply gas to China to rubles and yuan from euros. Russian institutions accounted for 4% of all offshore yuan payments made through the SWIFT system by July -- putting it in third place after Hong Kong and the UK. At the end of 2021, Russia wasn’t even in the top 15 countries with most offshore yuan payments.

Chinese currency bonds are also becoming a source of funding for some Russian firms. Oil giant Rosneft PJSC is readying the country’s biggest yuan-denominated bond. Polyus PJSC, Russia’s biggest gold miner, increased the amount of five-year yuan bonds it was selling to 4.6 billion yuan (\$660 million) from 3.5 billion yuan initially. Aluminum giant United Co. Rusal International sold yuan bonds in July.

Russia’s government is considering a plan to buy as much as \$70 billion in yuan and other “friendly” currencies this year to slow the ruble’s surge before shifting to a longer-

term strategy of selling its holdings of the Chinese currency to fund investment, Bloomberg News reported Sept. 1.

Even before the war, Russia had become one of the largest holders of reserves in the Chinese currency in the world.

Russia Raised Yuan's Share in Reserves in Recent Years

Bank of Russia's reserves in yuan

Source: Russia's central bank, estimates by Bloomberg

The yuan has a long way to go to truly challenge major peers. The Chinese currency accounted for 2.2% of global payments by value in July, up from 1.9% two years ago and compared with 41% for the greenback, 35% for the euro, and 6% for the pound, according to the Society for Worldwide Interbank Financial Telecommunication, or SWIFT.

Eswar Prasad, a professor at Cornell University and a China expert, said the yuan will get a boost from countries looking to skirt the dollar, although the greenback's dominance remains assured.

“The proliferation of new technologies that are reducing frictions in international

payments, along with the desire of many countries to circumvent reliance on the dollar, are likely to enhance the yuan's share of global payments," he said. "Still, it is likely this will at most amount to a modest shift in the next few years and certainly won't seriously undermine the dollar's status."

There are a number of hurdles to the yuan becoming a more global currency, including capital controls and the government's tight grip on how the yuan trades. China's legal system lacks the transparency of major trading rivals, while an aggressive crackdown on the technology industry and other sectors has spooked foreign investors.

Cyclically, the Federal Reserve's aggressive interest rate hikes are pulling investors away from Chinese securities -- outflows hit a record earlier this year -- while a property slump and ongoing economic hit from restrictions to curb Covid-19 have further dented the yuan's appeal. Slowing exports will have an impact.

Still, the currency is gaining ground, even if slowly.

The value of China's trade settled in renminbi reached a record high of 2.5 trillion yuan in the second quarter, according to data from the People's Bank of China, reflecting an exports boom that has only recently started to slow.

Settling in Yuan

China's trade settlement in yuan reached a record high in second quarter

Source: People's Bank of China

At the same time, central banks are gradually diversifying their dollar-denominated holdings. The yuan's share in official foreign exchange reserves rose to 2.88% in the first quarter of this year, up from 1.2% in 2017, according to the PBOC.

The International Monetary Fund gave the yuan a boost as well in May, lifting its weighting in the Special Drawing Rights currency basket to 12.28% from 10.92%. In the Hong Kong bond market, sales of corporate and government debt denominated in offshore yuan -- so-called Dim Sum bonds -- jumped to a record.

The pickup in two-way trade with Russia may also be bolstering China's cross-border interbank yuan payment system, run by CIPS Co.

While CIPS has only a fraction of transaction volumes compared with SWIFT, it's steadily growing. The daily average value of transactions handled by the CIPS system in the first half of 2022 was 21 times that of 2016, and most of the overseas yuan settlement banks have already or will soon be connected to the CIPS, according to chief executive officer Xu Zaiyue.

Sales Surge

Dim Sum bond issuance is the highest on record this year

Source: Bloomberg
Data includes government bonds and CD

The sheer weight of China’s global economic influence, its closer relations with the so-called BRICS countries of Brazil, Russia, India and South Africa, and the diversification by central banks will continue to bolster the yuan’s status, said Becky Liu, head of China macro strategy at Standard Chartered Plc.

“We expect faster progress of the renminbi’s internationalization in the years ahead,” she said.

– *With assistance by Enda Curran, Yujing Liu, Qizi Sun, and James Mayger*

(Updates with comments from China’s ambassador to Russia.)

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