The rise of the middle powers

US Dollar

China capitalises on US sanctions in fight to dethrone dollar

Beijing uses developing world chagrin over Washington's weaponisation of greenback to push global renminbi

Michael Stott and **James Kynge** in London AUGUST 24 2023

Argentina faced a familiar problem at the end of last month. The South American nation was struggling to repay the IMF $2.7bn from its latest $44bn bailout.

The solution, however, was unconventional. With its net dollar reserves in the red, Buenos Aires settled the payment partly in renminbi. "Argentina will not use a single dollar from its reserves to make the payment," economy minister Sergio Massa crowed.

The transfer in the Chinese currency was only Argentina's second to the IMF. "These are indications of broader changes happening in the international financial system, which will become permanent," a senior official at the Argentine economy ministry said. "These shifts will take time, but they will not be reversed."

On the other side of the globe, Bangladesh also alighted on the renminbi as the answer to a problem it had in April: how to make stalled payments to Russia for a nuclear power plant. Dollars were not an option because of US sanctions and rouble payment was not feasible for Dhaka, so the two nations opted for the renminbi instead.

Developing economies have long chafed at the dominance of the US dollar in international trade and finance, particularly as America's share of the global economy has more than halved since the second world war and new powers such as China, India and Brazil emerged.

"De-dollarisation" has been on the anti-imperialists' radar for decades but the overwhelming power of the US currency meant it amounted to little more than a slogan until recently, economists say.

Argentina's economy minister Sergio Massa said his country would 'not use a single dollar' to repay a loan from the IMF © Nathan Howard/Bloomberg

But with the expansion of US economic sanctions and the explosion of new technologies for international payments, cracks are starting to appear in the dollar's once-impregnable position. And China, with its embrace of the digital renminbi, or e-yuan, and its drive to develop an alternative global payments system, is hoping to take advantage.

The aim is not to depose the dollar but to chip away at its dominance — and, crucially, to create enough space for China's economic survival if the US one day targets it with the type of sanctions it has imposed on Russia.

"The US uses its financial power as a geopolitical weapon and the hegemony of the US dollar is a big part of this," said one Chinese official, who declined to be identified. "If the US targets any developing country with sanctions through the payments system, we will suffer."

The list of individuals and entities sanctioned by the US Treasury's Office of Foreign Assets Control (Ofac) now runs to 2,206 pages and lists more than 12,000 names. Their use has accelerated sharply in the past decade as successive US presidents have opted for an apparently low-cost, bloodless solution to foreign policy problems.

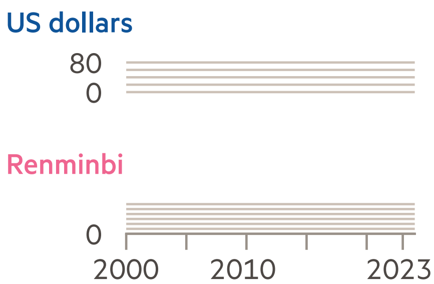
"The extraterritoriality implied is frightening other governments," said Christopher Sabatini, Latin America fellow at Chatham House. "When you have a quarter of the world economy under some form of sanctions and the threat that they can be used against any country at any time, that changes the game."

Agathe Demarais, author of *Backfire: How sanctions reshape the world against US interests,* traces three key developments: Iran being banned from the Swift global financial messaging network in 2012, economic sanctions on Russia in 2014 after its annexation of Crimea — making it by far the biggest nation ever sanctioned — and the US trade war with China starting in 2018.

"These three events really accelerated the shift in thinking of rogue countries . . . to turn away from western financial mechanisms," she said.

The dollar is dominant in FX reserves but its lead is starting to slip

Currency share of allocated foreign currency reserves (%)



FINANCIAL TIMES Source: IMF

Greatly expanded western sanctions have not just upset authoritarian states. They have also angered emerging powers such as Brazil, which believe the international financial system should not be weaponised.

“Today there is a lot of discomfort with the international financial system based on the dollar,” Brazilian president Luiz Inácio Lula da Silva’s top foreign policy aide Celso Amorim told the Financial Times. “The main factor behind that is sanctions.”

Eswar Prasad, professor at Cornell University, agrees that “practically every country around the world, including rivals as well as traditional allies of the US, would dearly love to ditch the dollar-denominated financial system,” though he points out that this is not easy.

The difficulty for emerging powers seeking an alternative is that the dollar is so deeply embedded in the international financial system. Economists have long held that the “network effect” of such widespread dominance will doom any effort to replace the dollar. But across the financial system, China has been chipping away at the US currency, offering its own alternatives.

Beijing's focus has been to gradually dilute the power of Belgium's Swift, the global platform through which about 90 per cent of money moved across borders is arranged. China's strategy to achieve this is multipronged, persistent and starting to show important results, analysts said.

A customer uses digital renminbi to make a purchase at a Beijing café © Simon Song/SCMP/Zuma/Alamy

One part is to create a larger pool of renminbi liquidity in offshore capital markets, so as to increase the supply of Chinese currency to traders and investors.

Another is the establishment of the Cross-Border Interbank Payment System (Cips), a Chinese rival to Chips, the world's largest private sector dollar clearing and settlement system, and to Swift. Total settlements on Cips jumped more than a fifth to Rmb97tn in 2022.

Other strands are the international launch of the digital renminbi, which allows for transactions to take place without going through Chips or Swift.

"That is going to become a totally different system . . . completely cut away from the western financial regulators," said Zongyuan Zoe Liu at the Council on Foreign Relations in New York.

"The e-yuan coupled with Cips would be quite a potent force for anti-western sanctions because in order for a sanction to be triggered [the US authorities] have to know the information about the transaction."

China's desire to promote its own currency has been stymied by the fact that it is not fully convertible. Nevertheless, in March the renminbi surpassed the dollar and became the most-used currency in China's own cross-border payments, according to China's State Administration of Foreign Exchange (Safe).

Stephen Jen, a former Morgan Stanley currency expert, said in a note in April that the dollar was losing its international reserve status much faster than generally accepted. When adjusted for exchange rate movements, he said its share of global reserves had fallen to 58 per cent in 2023 from 73 per cent in 2001.

While there are signs of real progress, other analysts caution that Beijing is still several years away from being able to even dream of breaking the US dollar's "hegemony".

President Xi Jinping with Crown Prince Mohammed bin Salman in Saudi Arabia last year. He told Gulf Arab leaders he wanted to see the renminbi used to trade oil and gas © Royal Court of Saudi Arabia/Anadolu/Getty Images

One success has come in offshore capital markets. Cross-border debt denominated in renminbi has boomed this year with sales of "panda bonds" by foreign issuers rising to Rmb75bn ($10.4bn) so far — already surpassing the full-year record set in 2021, according to Chinese data provider Wind.

Issuance of renminbi-denominated "dim sum" bonds in Hong Kong is also at a new high over the same period, having topped Rmb320bn, according to data from Bloomberg.

In energy markets, where dollar pricing is the global norm, President Xi Jinping told Gulf Arab leaders at a summit in Saudi Arabia last December that he wanted to see the Chinese currency used to trade oil and gas. The first renminbi-settled LNG transaction on the Shanghai exchange was reported in March between China's national oil company and France's Total.

Emerging powers have also been quick off the mark with digital payments systems, such as WeChat Pay in China, India's Unified Payments Interface (UPI), Pix in Brazil or Kenya's mobile money service M-Pesa.

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The west is lagging behind, with the US and Europe still examining the possibility of digital currencies and payments systems still dominated by Visa and Mastercard.

"China has pilot projects to settle bilateral trade in e-yuan with Thailand and the UAE [United Arab Emirate]," said Demarais. "This is a clear case of countries using technology to pre-empt sanctions, and China really wants to have a first-mover advantage."

Few believe the dollar is likely to be toppled from its perch soon. But they do see an increasingly fragmented international financial system, with the renminbi playing a bigger role. All this will satisfy emerging powers' desire to diversify.

This is the final part in a series on how the stand-off between America and China has ushered in a new era of opportunity for countries around the world
Part 1: The à la carte world: our new geopolitical era
Part 2: China's blueprint for an alternative world order
Part 3: UAE and Saudi Arabia — the Gulf powerhouses
Part 4: China capitalises on US sanctions in fight to dethrone the dollar

"This is less about the dollar losing its position as the world's top currency," said Daniel McDowell, a professor at Syracuse University. "But I genuinely do believe there are risks here for US power, especially the ability to use sanctions against China."

The chart accompanying this article has been amended to separate the dollar and the renminbi

Additional reporting by Andres Schipani in Lima and Hudson Lockett in Hong Kong