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The Asian Infrastructure Investment Bank, the New Development Bank and the Internationalisation of the Renminbi (RMB) – The New International Financial Institutions as Part of the Chinese Strategy to Build Up an International Reserve Currency

Rafael Ramos **Codeço**[*]
Independent Scholar, Brazil / Formerly SOAS, University of London

Abstract

China's economic rise is being followed by an increasingly assertive foreign policy, which is marked by criticism of the current international financial system and attempts to change it. Beijing's leading role in the launch of two international financial institutions (IFI) – the Asian Infrastructure Investment Bank and the New Development Bank – is a good example of these attempts. Chinese leaders are wary that international financial leadership necessarily requires the internationalisation of its currency, and their leading position within the new IFIs provides a good opportunity to internationalise the renminbi.

Keywords: *China, Asian Infrastructure Investment Bank, New Development Bank, RMB internationalisation, international reserve currency*

1. Introduction

China's impressive economic development in recent decades has elevated the country's global standing to the extent that it is increasingly capable of shaping the international economic order. More recently, China has been adopting a more assertive approach aimed at reshaping the current US-led system through the expansion of its leadership in trade and investment, the creation of new international financial institutions (IFIs), and the internationalisation of its currency, the renminbi[1] (RMB) (Sun, 2015: 28). The launch of the New Development Bank (NDB) and the China-led Asian Infrastructure Investment Bank (AIIB) has raised debates about China's ability to take advantage of the IFIs to enhance its economic power, for example, by advancing the internationalisation of the RMB (Kynge, 2014).

This paper attempts to assess China's involvement in the launch of the AIIB and NDB as part of its broader strategy to internationalise the RMB. As the IFIs in question are not exclusively subject to China's will, it is worth checking the political positioning of other shareholders. The likelihood of their complying with China's self-interests within the banks will be appraised here. It is also illuminative to analyse the IFIs' legal framework to explore the extent to which they are able to accommodate China's interests. A crucial issue addressed by this article, for example, is an investigation of the IFIs' ability to make loans denominated in RMB. It will also examine whether the AIIB and NDB's loans will increase China's foreign trade and investment, enhancing RMB's international role.

The examination of these issues helps clarify the relationship between the AIIB, the NDB, and the internationalisation of the RMB. The connection entails subtle causalities. As Prasad (2017: 248) claims, the creation of the new IFIs, the expansion of China's leadership in trade and investment, and the internationalisation of the RMB are intrinsically correlated and complementary. The AIIB and the NDB will pave the way for the enlargement of Chinese overseas trade and investment, which in turn will open new fronts for the global use of the RMB.

This paper will demonstrate that the new Banks are a part of China's broader strategy to upgrade the status of the yuan as an international reserve currency. Section One will provide an introduction to the IFIs, a review of what is being said about the internationalisation of the RMB and a brief description of the materials and methods used to conduct the research. Section Two provides the necessary background regarding international reserve currencies, including their pre-requisites, benefits, and the motivations that drive Beijing's interests. Section Three presents the argument that the new IFIs are going to promote three issues that are critical to the internationalisation of the RMB. Firstly and most importantly, the IFIs will enhance China's capacity to deploy RMB through loans. This fact, together with the increase in China's trade and investment flows, will result in two secondary effects: the increase of RMB offshore centres among China's trade partners, and the deepening of the RMB bond market. Section Four will analyse the tendencies counter to the advancement of the RMB internationalisation agenda within the banks, in particular the United States (US) opposition and the resistance of Chinese economic groups to the shifts in monetary policy. Finally, this paper concludes that the banks will serve as tools to promote RMB status, but they will have only a limited impact as the RMB internationalisation agenda will be constrained by the pace of China's financial markets reform.

The intention to launch the AIIB was announced by Chinese officials in 2013 as a means of meeting the increasing demand for infrastructure in Asia. Other countries in Asia, except Japan, reacted positively to the initiative and the Bank promptly gained massive support (Bob, 2015). By April 2015, AIIB had attracted 57 prospective members, including close allies of the US such as Great Britain, South Korea and Australia. By June 2018, the number of members had increased to 64. The US and Japan, however, have taken a wary approach, indicating that they perceive the initiative to be an attempt to challenge the current international monetary system (IMS) (*ibid.*).

The NDB was created in 2014 by BRICS (Brazil, Russia, India, China and South Africa) with the objective of meeting shortfalls in infrastructure finance in the member countries. The NDB also has a Contingency Reserve Agreement (CRA), which is a fund of US$100 billion aimed at providing financial rescue to members experiencing difficulties with their balance of payments (Ministry of External Relations, Brazil – *BRICS*, 2014). The genesis of BRICS was already marked by a declared desire to reshape international power relations in a manner reflecting the economic rise of emerging countries (Peruffo and Prates, 2016), which includes a reduced over-reliance on a limited number of reserve currencies (Danese, 2017). By engaging in such initiatives, China not only aims to reduce the influence of the dollar but also to stablish a political and financial foothold in the member countries that can be used to advance the use of the RMB in trade and finance (Prasad, 2017: 234).

China, as the main shareholder of the two IFIs and as the member state supporting them most enthusiastically, is in a strategic position to make better use of both IFIs to amplify its international economic power (Subacchi, 2017: 190). Although Chinese officials have been claiming that those financial institutions will complement rather than challenge the current US-led system, such claims should be taken cautiously. After all, in the initial phase of its rise as an economic powerhouse, where it still lacks political reputation and prestige, China tends to be over-respectful rather than defiant to the extent of triggering open political confrontation.

The phenomenon of currency internationalisation is commonly explained through two approaches in literature. The first explanation draws on the fact that currencies of major economies fully integrated in the global market are highly coveted for foreign trade and foreign direct investment (FDI) (Eichengreen and Kawai, 2015: 1). China, as the biggest merchandise exporter (International Trade Centre, 2017) and the third largest recipient and second largest source of FDI (OECD, 2017) already fulfils that condition.

The second approach highlights the functions played by national governments to seek an international role for their currencies. Although economic size matters, convenience, low costs and confidence are more important for currency internationalisation – predicates that are achieved as monetary authorities build up the adequate facilities and trust in the financial system (Cruz, Gao, and Song, 2015: 275; Nugée, 2010: 13)

The literature highlights transactional liquidity, credibility and international usefulness as prerequisites for a given currency to become an international reserve asset (Cohen, 2000: 5; Wheatley, 2013: 18). This paper analyses how the agenda of the AIIB and the NDB support the achievement of these three prerequisites. This analysis proceeds through an assessment of the IFIs' legal framework, their official statements, and the academic debates over this issue.

This paper also assesses the benefits of internationalisation of the RMB in light of China's international and domestic motivations. To this end, it analyses the work of Cohen (2012) who exposes a broad class of gains arising from the currency internationalisation process. Prasad's (2017) book and Sun's (2015) chapter are used to evaluate how China's international ambitions are coupled with the new IFIs and RMB internationalisation. The chapter by Nugée (2010) appraises the debates about the IMS with special emphasis on Chinese dissatisfaction with the outdated, dollar-centred IMS. The chapter by Volz (2014), in turn, sheds some light on the domestic motivations of the internationalisation of the RMB in China, and names the impetus it will give to China's financial market reforms. This paper also gathered a number of statements made by Chinese high-ranked officials as well as opinions conveyed in documents of Chinese monetary authorities and think tanks that demonstrate the intention to internationalise the RMB.

The main features of the NDB and the AIIB that can increase RMB's international role are also investigated here. In order to appraise the capacity of the Banks to make loans denominated in RMB, I have done an extensive search of the official documents of both IFIs, such as the Articles of Agreement (AOA) and Policy on Financing Operations. These documents were evaluated together with the decision-making process and the shareholder composition of both institutions to illustrate how China has to persuade other shareholders, some closely allied to the US, to put forward the RMB internationalisation agenda within the AIIB and NDB. Moreover, the works of Subacchi (2017) and Griffith-Jones (2015) provide a comparison between the lending capacities of the NDB and the Chinese policy banks, which enables an assessment of the relative impact of the new IFIs.

Understanding the drivers behind the creation of currency clearance arrangements and their importance for the currency internationalisation process is essential to appraise how the new IFIs will enhance the RMB's international role. To this end, this paper utilised the chapter by Cheung (2015), the 2016 report of the People´s Bank of China (PBC) and a report from the Renmin University of China on the RMB internationalisation together with data analysis on the trade flow between China and some of its main commercial partners, to explain how the large-scale deployment of RMB and the increase of trade and investment flows between China and other members of the IFIs will create the necessary conditions for the proliferation of RMB offshore centres.

Another crucial issue to this paper is linking the AIIB and the NDB with the expansion of RMB bond markets. According to Cohen (2015), a well-developed bond market gives extra incentives to financial agents to hold a given currency, since it will represent an attractive alternative to park their assets. This paper analyses the NDB's bond issuance strategy vis-à-vis the current stage of development of the RMB bond markets in order to estimate the impact of the new IFIs on the expansion of the RMB bond market.

2. Background

2.1. Pre-requisites of a Reserve Currency

Reserve currencies need to fulfil some pre-requisites. The most commented on literature are credibility, usefulness and transaction liquidity (Cohen, 2000). The attainment of such pre-requisites would require much effort and reform from the Chinese monetary authorities. This section briefly mentions the pre-requisites of international reserve currencies with the aim of assessing, in Section 3, how the NDB and the AIIB will enhance the prospects of the RMB achieving such pre-requisites.

Credibility signifies the trust that the currency holders will put in a currency's long-term value, which is reliant on credible monetary and fiscal systems of the issuing country and political stability (*ibid.*).

Government creditworthiness, built upon the development of rules and institutions that ensure the market functioning with no manipulation and the enforcement of contracts by impartial courts, is of fundamental importance to a currency's reputation (Cohen, 2015: 234). The extraordinary acceptance of the dollar, for example, was forged by a solid credit record in which the treasury has honoured debts owed to private citizens for centuries (Wheatley, 2013: 18).

A not less important characteristic of a reserve currency is its usefulness. The currency's utility can be compared with that of a language: the incentives to use a given language depend on the number of people with whom one can communicate. In the same manner, a currency's international usefulness increases with the number of global players using it (Dowd and Greenway, 1993: 1189). Nugée (2010: 11) explains that "since one of the main qualities that those financial operators are seeking is general acceptance of the currency by other operators, the choice tends to be made on the basis of consensus and critical mass rather than anything more scientific or precise". Consequently, the establishment of the most widely used currency is not enforced by law or any other hard power, but is stablished by the natural choices made by financial operators on a rational basis.

The transactional liquidity comprises the existence of a well-developed and broad domestic financial market that offers a wide range of short- and long-term investment opportunities in that currency as well as free convertibility (Cruz, Gao and Song, 2015: 272). In this sense, the easier the access to a given currency, the higher the incentive of the financial operators to acquire it, since they "need to be assured that the availability of the medium of international exchange is not in doubt; and they need to be able to acquire it easily and at reasonable expense" (Nugée, 2010: 11). US markets' unrivalled depth and liquidity, for instance, are very important to the dollar's status of main international reserve currency, since the US dollar holders have no reason to distrust that they can sell billions in treasury bonds without risk of price collapse (Wheatley, 2013: 24).

Although it is not within the scope of this paper to detail the efforts that the Chinese government is making to enhance RMB's liquidity, it is important to emphasise that the monetary authorities have already started a series of reforms that are gradually liberalising the financial market and making the currency more liquid (Eichengreen and Kawai, 2015: 4).

2.2. Benefits and Motivation: RMB Leveraging the Chinese International Clout

The status of international reserve currency can entail enormous political and economic advantages to the issuer country. The classical literature drawing from political science and economics identifies five types of gain: the reduction of transaction costs, seigniorage, macroeconomic flexibility, leverage of influence and reputation (Cohen, 2012). The reduction of transaction costs occurs as individuals benefit from trading overseas in local currency, thus minimising exchange rate risk and increasing profits (*ibid.*). Seigniorage is the monetary gain that happens whenever foreigners acquire any amount of domestic money to buy goods, services or liabilities (*ibid.*). It represents an implicit economic gain, since the issuing central bank receives money in exchange for banknotes that cost almost nothing to print (Wheatley, 2013: 9). The gains of seigniorage are very important for the US, allowing it to finance its current account deficit easily and cheaply[2] (Benigno, 2010: 23). It can also enhance the macroeconomic flexibility on monetary and fiscal policies by loosening constraints of the balance of payments. Since the ability to finance external deficits with the domestic currency increases, the government's capacity to pursue policy objectives also increases as the issuer has more latitude to manage domestic employment levels and price behaviour (Cohen, 2012).

More direct benefits that China can obtain with RMB internationalisation are international leverage and reputation. This means, in this context, the influence that the issuer of a reserve currency enjoys from the dependence created when other countries rely on the domestic currency for any purpose (*ibid.*). A reserve currency issuer is able, for example, to exert pressure on uncooperative governments by threatening to exclude them from the national banking system, thus blocking a critical channel for trade payments (Wheatley, 2013: 9). Moreover, the issuer of a major reserve currency, having lower borrowing costs and high capacity to mobilise financial resources from creditors, can print out a vast amount of money without the constraint of running up fiscal deficits (*ibid.*: 17). This is in fact the main explanation of the US's extraordinary capacity to maintain its military supremacy for such long periods.

To contextualise the AIIB and the NDB in the strategy of RMB internationalisation, it is important to highlight the motivations driving China towards that end. Chinese commentators have been demonstrating an increasing concern regarding the depreciating trends of the dollar as the American fiscal deficit worsens (Hong, 2018). This concern relates to the quantitative easing policies carried out by the US administration to remedy the financial and economic crisis. As the US Treasury keeps issuing large amounts of dollars, China, as the biggest international holder of dollar assets, is naturally concerned that its assets are depreciating (Nugée, 2010: 10). Beijing is convinced that American quantitative easing is only possible because of the dollar-centred IMS, and sees RMB internationalisation as a means of reducing its dependence on the dollar: the more Chinese companies can clear their foreign trade transactions in RMB, the fewer dollar assets the PBOC needs to purchase (Cintra and Pinto, 2016: 393; Cheung, 2015: 207). Chinese financial agents are already reflecting this scenario on the price of American Treasury Bonds. In early 2018 China's most prominent rating agency, Dagong Global, downgraded federal treasuries to BBB+ with a negative outlook, on the grounds of the growing fiscal deficit and the weakening repayment ability of US government (Poenisch, 2018)

The internationalisation of the RMB is also likely to match the reform of the domestic financial sector (Volz, 2014). The currency internationalisation process requires broader opening-up of capital accounts, as well as the relaxation of some financial constraints that will ultimately give market forces greater sway over interest rates and the exchange rate (Di, 2013). The natural outcome of this process would be an upward pressure in the price of the RMB that, in turn, would contribute "to rebalance Chinese growth away from an export-led to a domestic consumption-led dynamic" (Minikin and Lau, 2013: 7).

Elevating the RMB to one of the world's dominant currencies is among the international objectives of the Chinese government, which sees the existing IMS as a source of undue privileges (Prasad, 2017). According to Chinese commentators, the role of the RMB would also involve challenging or even breaking the dollar dominance that inhibits the multivariate competition in global trade (International Monetary Institute, Renmin University of China, 2017). The internationalisation of the RMB also resonates well with the ambitious foreign policy of the new Chinese leadership and its view of the "great rejuvenation of the Chinese Nation", as it would enhance Chinese international influence (Volz, 2014). With this in mind, granting a leading role to the RMB is fundamental for establishing a new, "proper" world order that reflects China's elevated economic strength and political status (Sun, 2015: 28). Indeed, during the occasion of the first RMB bond issuance outside China (at London Stock Exchange), high-ranked Chinese officials praised the initiative as a milestone of a greater international role of the RMB and an important step towards the stability of the Chinese economy (Bank of China, 2016).

The 2016 PBC report enumerates various actions carried out in 2016 to further facilitate cross-border business in RMB, which indicates a steady commitment of Chinese authorities with the internationalisation of the RMB (The People's Bank of China, 2016: 60). The same report also highlights the efforts taken by the Chinese monetary authority to incentivize the orderly development of overseas RMB lending (The People's Bank of China, 2016). There are thus many reasons to believe that China will take advantage of all the possibilities to upgrade the RMB as an international reserve currency. Some of these possibilities will be bestowed by the AIIB and the NDB, which will be demonstrated in the next section.

3. AIIB and NDB: New Arms of the Chinese Financial Statecraft

This section explores the main features of the AIIB and NDB that make them likely to enforce the trend of RMB internationalisation towards the status of a major international reserve currency. It is divided into three core cases. The first is increasing the capacity of loans denominated in RMB. The second core case – the increasing number of RMB offshore centres – is a consequence of the first. As the member countries receive loans in RMB, they will naturally create offshore centres to exchange RMBs for local currency. The third core case addresses the deepening of the RMB bond markets, which derives from the fundraising process of both banks.

Table 1 A Comparison of AIIB, NDB and World Bank

	AIIB	NDB	World Bank
Total capital	US$100 billion	US$100 billion	US$268.9 billion
Subscribed capital	US$100 billion	US$50 billion	US$268.9 billion
Paid-in shares	US$20 billion	US$10 billion	US$16.1 billion
Headquarter	Beijing	Shanghai	Washington DC
Number of employees	Around 50	Around 50	More than 10,000

Sources: *Caixin* (2016); World Bank (2017).

3.1. Loans in RMB

The AIIB and NDB have a considerable financial capacity. Despite the short period of their existence, their total capital is worth US$100 billion each, making their size almost half that of the World Bank (see Table 1). This core case, however, is more applicable to the AIIB than to the NDB. A stated policy goal of the NDB is to increase the amount of loans denominated in local currency (New Development Bank, 2017c), which means the banks will promote loans in the currency of the country where the projects are being financed. By doing so, the NDB will be acting to reduce US dollar dependence within its members; therefore, if not strengthening the use of the RMB, it will weaken the position of the dominant global reserve currency.

By early 2017 NDB signed its first loan agreement to be funded in RMB in China (New Development Bank, 2017c). Despite its principle of lending in local currency, it is important to highlight that NDB's "General Strategy 2017 – 2021" allows funding in any other hard currency. The document states that the funding currency will be chosen "according to market conditions, investor demand and the cost of funding" (New Development Bank, 2017d: 25). Some commentators, however, cast doubt about the ability of the NDB to fund in RMB or any local currency. The strict regulations of the Chinese financial markets as well as the advantages of borrowing in dollar, they argue, can discourage borrowers to accept loans in RMB or any other currency (Shelepov, 2016). Although this may be true, it is important to recapitulate the recent reforms aiming to liberalise the Chinese financial markets. As the RMB becomes increasingly convertible and liquid, it is likely that lending in RMB in the near future will match the requirements of "investor demand and cost of funding" as stated in the NDB's General Strategy.

The AIIB's framework is even more susceptible to accommodate the Chinese will of lending in RMB. Its statutory regulations, such as the Operational Policy on Financing (AIIB's OPF) and Article of Agreement (AIIB's AOA), contain some rules regarding lending in RMB. The general rule, stated in Article 4.2.1 of the AIIB's OPF, is that loans are committed and repayable in US dollars. The same article, however, states that "at such time as the Bank determines that it is in a position to offer loans in other currencies, loans may be committed and repaid in such other currency or currencies as the Bank is able to hedge itself efficiently from time to time" (AIIB, 2017b). Article 3.1.5 of the same statute also allows AIIB to ''provide financing in its operations in the currency of the country concerned, in accordance with policies that minimize currency risk" (AIIB, 2017b). Moreover, the AIIB Asset Liability Management Policy states that ''the Bank may offer loans denominated in currencies other than US Dollars whenever it has the means to adequately operate in other currencies and manage risks unique to the products'' (AIIB, 2017c).

If the AIIB is to make loans denominated in RMB, it therefore has to follow a specific procedure to determine that it "is in a position to offer **loans in other currencies**" and "it has the means to adequately operate in other currencies and manage risks unique to the products". Article 28.2.1 of the AIIB's AOA states that "except as otherwise expressly provided in this Agreement, all matters before the Board of Governors shall be decided by a majority of the votes cast" (AIIB, 2015). In other words, the AAIB would be allowed to make loans denominated in RMB if more than 50 per cent of the Board of Governors decides so.

Given the geopolitical implications of this, it is important to analyse the likelihood of such a decision coming to be approved by the shareholders. Due to lack of space of this paper, it is impossible to assess the likelihood of every AIIB member complying with China's aspirations. However, only the voting shares of member countries that are already engaged in monetary initiatives aimed at changing the current IMS (which is the case of the BRICS countries) already account for 41.69 per cent of all AIIB's voting shares. We can add the voting shares of countries that are under US sanctions, and thus tend to be uncooperative with the dollar-centred IMS, which is the case of Iran and other prospective members (see Table 2).

The possibility of disbursing loans denominated in RMB will give China a valuable opportunity of deploying the RMB on a large scale, increasing the prospects of its internationalisation in the long run (Sun, 2015: 33). Indeed, the International Monetary Institute, a Chinese think tank affiliated to the Renmin University of China, encourage the use of RMB along the Belt and Road "to compensate the shortage of the US dollar liquidity and enhance the RMB internationalisation while meeting the demands of those countries' national economic development".

Table 2 Voting Shares of BRICS and Iran in the AIIB

Member	Capital subscription	Voting power
China	US$29.78 billion	27.5186%
India	US$8.37 billion	7.9254%
Russia	US$6.54 billion	6.2499%
Iran	US$1.58 billion	1.7156%
Total	US$46.27 billion	43.4095%

Source: AIIB (2017a).

Although the AIIB only has a regional reach, it would be important as a first move of a broader internationalisation of the currency (Lim and Kim, 2017).

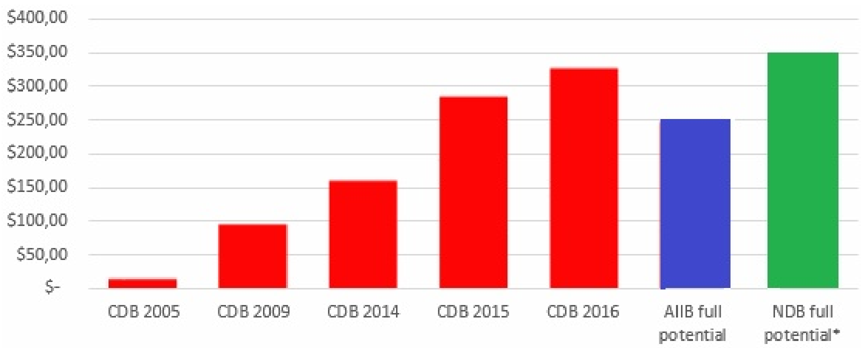
It is worth revisiting the rise of the dollar as the main global reserve currency at this point. The huge loans provided by the US under the Marshall Plan greatly expanded the volume of the American currency in Europe, which contributed to its reputation and expedited its internationalisation (Cheng, 2015: 368). The Belt and Road Initiative (BRI), which uses the AIIB and NDB as the means by which it will deploy huge loans throughout Asia, arguably plays the same role for China as the Marshal Plan did for the US (Power, 2015). Chinese specialists argue that the RMB, as the strongest currency among the Belt and Road regions, should be used to finance the related projects (Shen, 2016).

Jin Liqun, President of the AIIB, has however announced on January 2016 that all of AIIB's loans will be in dollars (Coats and Di, 2016), which is consistent with the AIIB's OPF general rule. Mr. Jin's announcement indicates that Beijing will not use the AIIB as a platform to promote RMB internationalisation. However, this declaration of intention cannot be taken so adamantly. China as a potential challenger of the US hegemony is not supposed to demonstrate its rivalry so clearly before becoming strong enough for open confrontation. As China strengthens its position as a responsible stakeholder of the AIIB and a major player in the global economy, it is likely to adopt a more assertive attitude towards the agenda of internationalisation of the RMB within the AIIB.

To better assess the impact of AIIB and NDB lending on RMB internationalisation, it is nevertheless important to compare their potential with those of the so-called Chinese policy banks, especially the Chinese Development Bank (CDB) and the China Exim Bank. Between 2009 and 2010, the aforementioned banks lent nearly US$110 billion overseas (Subacchi, 2017: 46). The CDB's outstanding loans abroad rose from US$16.2 billion in 2005 to US$276 billion in 2015, including 69 billion denominated in RMB (China Development Bank, 2017). The figures are murky and there are divergences in the sources, but given their huge amount, there can be few doubt about their importance to the internationalisation of the RMB.

Due to the short existence of the AIIB and NDB, with both banks still in their initial phases of capitalisation, it is wiser to assess their lending estimates instead of the amount they have lent so far. According to Griffith-Jones (2015: 3), the NDB's lending capacity after 20 years may reach US$34 billion yearly, which is comparable to the level of European Investment Bank and larger than the World Bank's lending for infrastructure. The AIIB, on the other hand, is already authorised to lend the equivalent of 2.5 times its capital, what would totalise the outstanding amount of US$250 billion (Kynge, 2017). Figure 1 compares the historical and current level of the outstanding loans of CDB with the expected future loans of the AIIB and NDB to elucidate the relative potential of the new IFIs.

Figure 1 CDB Outstanding Loans *v.* AIIB and NDB Expected Outstanding Loans (US$ billion)



*potential to be achieved in the period of 20 years as estimated by Griffith-Jones (2015:3).

Sources: Prasad (2017: 243), *China Daily* (2015), Kynge (2017), Griffith-Jones (2015: 3) and China Development Bank (2017).

The long-term lending potential of the new IFIs is by no means negligible. However, considering the long period that AIIB and the NDB will take to achieve their full potential, it is reasonable to assume that China's policy banks' lending abroad are considerably more impacting. The intense disbursement of capital by the Chinese policy banks is nevertheless not the best approach if China wants to increase its financial influence abroad. Many countries that have been receiving Chinese loans have been expressing preoccupation about the potential risks of building such an imbalanced relationship in terms of economic power and financial resources (Subacchi, 2017: 46). For this reason, with the AIIB and the NDB, China will gain more authority for its financial assistance, as the IFIs will provide a kind of legitimacy stamp for its loans (Sun, 2013; Cintra and Pinto, 2016: 397; Prasad, 2017).

3.2. The Proliferation of RMB Offshore Centres and Swap Arrangements

An offshore currency centre is defined as a financial centre that provides services of currency clearing, trade settlement and investment products denominated in currencies not issued by that offshore market (Minikin and Lau, 2013: 140). The increasing number of RMB offshore centres would improve RMB liquidity overseas (*ibid.*) and separate the currency risk from the country risk, since the former becomes combined with the risk of the country where the offshore market is located (Cheung, 2015: 209). Provided that China neither enjoys financial regulations assuring liquidity nor good reputation in the rule of the law, the intermediation of an offshore centre might constitute an important incentive for a non-resident to use RMB.

Cheung (2015: 232) praises the importance of the offshore markets in the rise of the dollar as the main international reserve currency in the 1950s and 1960s, when the proliferation of offshore centres such as the Eurodollar was of fundamental importance to its emergence as a global currency. In the case of the RMB, the offshore arrangements will elevate its liquidity to the level of the major developed currencies, since it will remain out of the reach of the PBOC's tight monetary controls, hence making it readily used for payments or switched for other currencies (Prasad, 2017: 111). In light of this, the offshore RMB approach is a clever solution to circumvent the underdeveloped domestic financial market and to avoid the strong monetary controls in mainland China (Cheung, 2015: 208). China's trade partners, consequently, will be more willing to hold RMB to pay for the import of Chinese goods, which will further promote the RMB as an international reserve currency (Fung, Ko and Yau, 2014: 10).

The motives for the establishment of a RMB offshore centre in a given country are directly related to the volume of money that flows from China abroad and vice versa. China's extensive trade and investment networks are the main drivers of the proliferation of RMB offshore centres around the globe (Minikin and Lau, 2013: 131; Cheung, 2015: 218). Trade settlement in RMB entails advantages to importers of Chinese goods, since it contributes to the reduction of exchange risk against the dollar and protects them from a shortage of trade funding during financial crises (Fung, Ko and Yau, 2014: 10). As China's commercial partners begin envisaging the advantages of trading in RMB, there will be demand for currency offshore services (Minikin and Lau, 2013: 58). The main driver of the creation of currency offshore centres is therefore the high volume and consistent flow of money across the border. Particularly in the case of China, the creation of RMB offshore markets represents an extra advantage, since it enhances the currency's liquidity and trust and reduces transaction costs, which in turn reinforces the use of RMB for trade settlements in a virtuous cycle.

The AIIB and NDB expedite the creation of RMB offshore centres in two ways. The first is through the likely disbursement of loans denominated in RMB. As the member countries start to receive large quantities of RMB to fund infrastructure projects, they will require the development of offshore centres to swap RMB for local currency (*Week in China*, 2016). It is not hard to presume that the loans denominated in RMB will make its internationalisation similar to that of the dollar after the Marshall Plan. In that case, the provision of loans in dollars to European countries created a cross-border need for currency circulation that in turn stimulated the emergence of the offshore dollar market (Cheung, 2015).

The second way by which the AIIB and the NDB will advance the creation of RMB offshore centres is by reinforcing the economic ties, via trade and investment, between China and the Banks' members. Both IFIs are meant to finance infrastructure projects, a sector where Chinese companies accumulate a large expertise and are extremely competitive (Lim and Kim, 2017: 3). The chance that Chinese companies will succeed on the procurement process for funding the infrastructure projects of AIIB and NDB are therefore high (Harris, 2015: 39; Jin, 2015; Koike, 2015).

China´s involvement in AIIB and NDB not only boosts infrastructure-related sectors but also increases bilateral trade through the enhanced interconnectivity. It may also promote RMB use in the projects financed by the multilateral banks as well as new trade deals between China and the Banks' other partners (Huang and Xia, 2018). Expansion of FDI will also enhance the international use of RMB by providing an impetus for domestically funded financial institutions to go global and develop offshore RMB business (International Monetary Institute, Renmin University of China, 2017). The recent data show that the share of Chinese foreign investment to the countries of BRI increased to 12 per cent of total outbound investment from 8 per cent in 2016 (Huang and Xia, 2018) and more than half of RMB trade settlement occurs in the areas along the BRI (International Monetary Institute, Renmin University of China, 2017). Given the massive scale of the projects the new Banks are going to fund, the trade and investment flows between China and the Banks' members are likely to increase considerably, thus promoting the creation of new RMB offshore centres and new swap arrangements.

The PBC official data show RMB trade settlement reached 9.85 trillion yuan and about 240,000 domestic companies were using RMB to conduct cross-border trade settlement by the end of 2016. Moreover, in the same period, banks from 129 foreign jurisdictions and enterprises from 146 countries opened about 29,400 RMB accounts in China (The People's Bank of China, 2016). It is important to emphasize that the pace of RMB internationalisation slowed down since 2016. From the side of the external environment, the uncertainties created by the US election as well as the expectation of a rise of the interest rate by the Federal Reserve (Fed) caused a large quantity of capital flow back to the United States. There were also domestic factors such as Chinese economic slowdown and tighter capital policy that affected the international use of RMB (International Monetary Institute, Renmin University of China, 2017). Nevertheless, analysts are optimistic that a variety of initiatives will turn the decline around and lead to the greater international use of RMB. One of the biggest drivers will be the Belt and Road Initiative, which has as main financier the AIIB and the NDB (SWIFT Business Intelligence, 2018).

Several RMB clearing arrangements have emerged in virtue of a steady flow of trade and investment involving China and its partners. According to data from PBC, by the end of 2015, there were 36 bilateral swap arrangements signed by China with the total size exceeding RMB 3.3 trillion (The People's Bank of China, 2016: 61) and, by the end of 2017, over 60 countries and regions have adopted the RMB as reserve currency (Mo, 2017). Moreover, the International Monetary Fund database reports that RMB-denominated assets grew from the equivalent of US$91 billion at the end of 2016 to US$107 billion in the third quarter of 2017. Accordingly, the share of RMB-denominated assets grew from 0.78 percent to 0.96 percent of the global total of foreign reserves (Xia, 2018). The figures show a renovated trend of the RMB internationalisation after a period of stagnation. Much of this new impetus was made possible by a greater presence of Chinese companies abroad. It is not unreasonable to expect, therefore, that the new trade and investment channels that AIIB and NDB will open for China will create the same stimulus for the establishment of new RMB offshore centres.

3.3. The Emergence of a Deep Bond Market

The RMB bond market can be defined as the bulk of financial assets and derivatives denominated in the Chinese currency available for investment (Fung, Ko and Yau, 2014: 103). It serves also as an alternative to borrowing in RMB since governments, enterprises, and financial institutions can issue RMB-denominated bonds to raise funds (Subacchi, 2017: 127). The RMB bonds commercialised onshore for non-Chinese residents are known as Panda Bonds, whereas their offshore counterparts are designated as Dim Sum Bonds. It is important to highlight that the Panda Bonds correspond only to a small fraction of the total RMB onshore market, but is still more important for measuring internationalisation as it can be issued by non-residents (Minikin and Lau, 2013: 12).

A deep and broad bond market is important for the international use of RMB because it offers additional opportunities for investors to hold RMB-denominated funds for investment, thus reinforcing it as investment medium and reserve currency (Cohen, 2015: 232). The existence of a varied range of RMB-denominated assets further encourages trade settlement in RMB. Having attractive options to park RMB receipts, foreign companies would be more willing to accept the currency in payment (Minikin and Lau, 2013: 12). As Subacchi (2017: 127) puts it, "the more RMB denominated instruments, the less onerous and constraining it is to hold it." Consequently, the more the investment options in RMB, the more convenient for overseas investors to increase their holdings in RMB (E, 2018). According to Prasad (2017: 252), the unrivalled depth of the dollar bond market gives the American currency an enormous advantage as a medium of investment. For the RMB to emerge as a global reserve currency, therefore, China has to develop the RMB bond markets by expanding the bulk of assets available to invest in. By doing so, investors and national governments will be prone to hold RMB assets, and companies trading with China more willing to accept payments in RMB.

There are two means by which the AIIB and the NDB will further the development of the RMB bond market. The first is by issuing RMB-denominated bonds to support their fundraising process. As discussed above, this enhances the prospects of internationalisation of the RMB by diversifying the currency's investment portfolio and encouraging companies, governments, and investors to hold financial assets denominated in RMB. The fundraising process, in turn, is likely to give member countries the opportunity to become offshore centres, since they will be eligible to take up the role of selling the bonds issued by the IFIs (Hong, 2015).

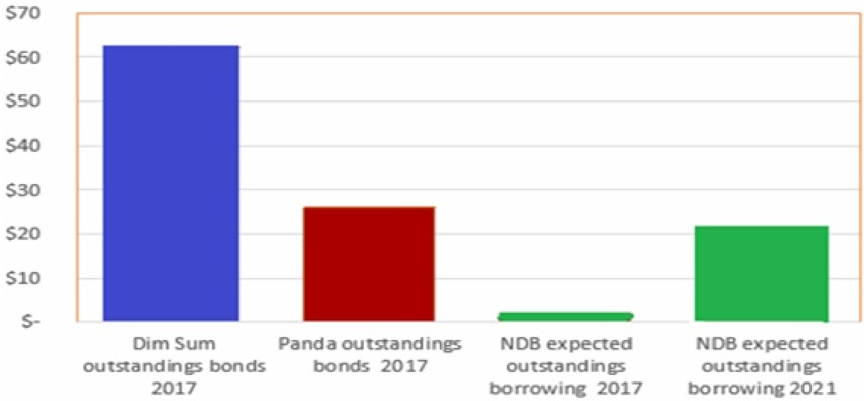
The second front that the IFIs will help to develop the RMB bond markets, which is more attainable in the case of the AIIB than the NDB, is through the growth of the trade settlement in RMB. Since AIIB members are likely to increase their commercial and investment transactions with China, their central banks and companies will have extra incentives to hold RMB for future transactions (Sun, 2015: 33). Member countries are thus likely to consider allocating part of their foreign currency reserves in RMB, which will expedite the currency internationalisation process.

So far, save for one single bond issuance carried out by the NDB, every other capitalisation of both Banks has been conducted in US dollars, which would suggest that they do not intend to use RMB. According to the AIIB treasurer, however, the initial capitalisation was expected to be in US dollars as that is the Bank's official currency, but the IFI is likely to use RMB at a stage when it makes sense for the AIIB to do so (Tani, 2017). Wang (2017) also believes that both IFIs will likely use RMB in the next capitalisations. Indeed, the NDB *Annual Report 2016* states that the Bank "will continue to explore further local currency bond issuances in China" (New Development Bank, 2017a: 32). Moreover, the NDB Budget Summary for 2018 projects ''to raise between USD 1 billion to 1.5 billion through a mixture of issuances in USD and local currencies'' (New Development Bank, 2017b). Accordingly, the PBC 2016 report highlights the deep support of Chinese authorities for the issuance of RMB-denominated bonds by the NDB (The People's Bank of China, 2016), which indicates that Beijing will seize the opportunity provided by the new IFIs to further develop the RMB bond market.

The AOA of both IFIs contain the permission to issue financial assets for fundraising purposes. Article 16 of the AIIB's AOA states that "the Bank may raise funds, through borrowing or other means, in member countries or elsewhere, in accordance with the relevant legal provisions" (AIIB, 2015). The NDB's legal framework not only allows the issuance of financial assets, but also encourages it to "utilize external investment – mainly via bond issues on capital markets" (New Development Bank, 2017c). In July 2016, the bank issued RMB 3 billion (equivalent to US$445 million) in China's interbank green bond market (New Development Bank, 2017a).

The Chinese state-owned banks have been the largest issuers of RMB bonds in offshore markets. According to Fung, Ko and Yau (2014: 70), it is a part of China's strategy to internationalise RMB. To support their argument, they cite a part of the mandate of an issued bond, which makes explicit the aim of "promoting the development of the offshore renminbi business in Hong Kong, and promoting the settlement for and circulation of RMB in the surrounding countries and regions" (*ibid.*). Given the Chinese influence on the AIIB and NDB, it is reasonable to imagine that Beijing will push for the issuance of RMB-denominated bonds in the next capitalisations.

Figure 2 Dim Sum and Panda Outstanding Bonds *v.* NDB's Expected Bond Issuance (US$ billion)



Sources: Bloomberg (2017); New Developmet Bank (2017c).

To best evaluate the impact that the AIIB and NDB can have on the development of the RMB bond market, it is worth checking the bond market's current size vis-à-vis the Bank's potential for issuing bonds. The NDB has publicised its Funding Strategy, stating that it intends to raise funds "mainly via bond issues" worth up to US$1,950 billion in 2017, reaching the outstanding amount of US$21 billion by 2021 (New Development Bank, 2017d: 24). Although the AIIB has not disclosed any information about bond issuances, it is reasonable to presume that it will keep to the same level of the NDB, if not higher (Wang, 2017: 115).

The most recent data shows that the outstanding volume of RMB bonds in the Panda and Dim Sum Bond Markets amounted, in August 2017, to US$26 billion and US$62 billion respectively (Bloomberg, 2017). The amount of bonds that NDB itself intends to issue in 2017, therefore, is equivalent to 2 per cent of the outstanding value of the Dim Sum and Panda Bond markets combined (see Figure 2). Taking into account the short existence of the Bank and the expected increase of bond issuances until 2021, the contribution that NDB can make to the RMB bond market will be considerable. Considering the future bond issuances of the AIIB, the impact is even more substantial.

Despite the fact that the new IFIs can contribute considerably to the development of the RMB offshore markets, it is important to emphasise that the main limitation to their development is the low liquidity of Chinese financial markets. E (2018) cites that offshore investors fear the restricted freedom of movement of funds as well as the insufficient market liquidity when entering China's bond market. Operators of Dim Sum Bonds highlight that, no matter how diversified the portfolio of financial assets, the lack of liquidity has been making it difficult to find buyers for the securities (Bloomberg, 2017). The same applies to the Panda Bond Market, where restrictions to repatriate the capital from China has been discouraging foreign investors (Reuters, 2017). The AIIB and the NDB, therefore, are likely to make an important contribution by issuing RMB-denominated bonds, thus diversifying and deepening the RMB Bond Market. Its further development, however, will depend on the approach that Chinese monetary authorities will adopt on the regulation of the financial markets, which will be further discussed in Section 4.2.

4. Counter-tendencies

4.1. US Opposition: A Dispute over an Exorbitant Privilege

Section 2.2 demonstrated the benefits China will enjoy from the internationalisation of the RMB. Some of those benefits, notably "Leverage" and "Reputation", will occur at the expense of the US's financial clout and the dollar's prestige (Prasad, 2017: 252). The US, indeed, is wary that the rise of China coupled with some financial consequences, such as the internationalisation of the RMB, might eventually undermine its supremacy (Callaghan and Hubbard, 2016). Since such a development can erode the benefits enjoyed by the dominant reserve currency, such as seigniorage and financial influence over other countries, it is reasonable to expect some reaction by the US to block initiatives aimed at internationalising the RMB within the new IFIs.

There are, however, competing views regarding this issue. The necessary steps that China has to take in order to increase the convertibility and liquidity of the RMB will imply looser monetary control over its currency (Volz, 2014). If the PBOC is thus to enhance the RMB's convertibility and liquidity, it will necessarily have to release control over the capital account that, ultimately, will make the exchange rate more similar to the market rate. Consequently, Chinese exports would lose competitiveness, which would alleviate the huge trade deficit that the US bears with China.

According to Subacchi and Drifill (2010: 122), the perception that RMB internationalisation is benefiting the US, which remains concerned with its trade deficit, neglects the potential consequences of the deterioration of the dollar's "exorbitant privilege". The idea of a smaller trade deficit thus undoubtedly pleases American authorities, but the counterpart of the trade-off certainly horrifies them to the extent that they might try to block it at any cost. The US's ability to hamper the RMB internationalisation agenda within the AIIB and the NDB could be realised by influencing IFI members to prevent the Bank from either lending or issuing bonds denominated in RMB. As demonstrated in Section 3.1, the composition of the voting shares of the IFIs are favourable to China, but Beijing's ability to control all decisions is an open question.

In the case of the AIIB, for example, the accession of so many shareholders is on the one hand a victory for Chinese diplomacy. On the other, it makes it hard for China to turn the Bank into an instrument of its foreign policy (*The Economist*, 2015). The extent to which Beijing will use the Bank to advance its national interests will be subject to the scrutiny of the other members. Harris (2015: 39) highlights some motivations that led China to set up the IFI, such as export promotion for Chinese goods and services, support for China's One Belt, One Road strategy, and an attempt to boost its international influence. According to him, the international community's awareness of the intentions regarding the Bank already caused criticism and this is likely to increase as China lets its own commercial and political considerations take priority (*ibid.*).

To figure out how China's behaviour has been shaped by the other members of the AIIB, it is worth recovering some facts that happened since the negotiations of its constituency. Sun (2015: 28) praises the negotiation of the AIIB's AOA as a process where Beijing became aware of the incompatibility of some of its initial objectives, in turn leading the negotiators to adapt its intentions. She argues that the AOA today is considerably different from what Chinese authorities expected before 2015, and that the evolution of the AIIB may indicate a trend for a future conflict of interest within the Bank, where China's intentions can be accommodated without overturning the current global financial order (*ibid.*).

Harris (2015: 41) highlights that the criticism and opposition from Japan and the US also played a decisive role in dissuading Beijing's ambitions for pushing its own agenda. Whereas some commentators might still perceive AIIB as a case of China threatening the current international order, the events so far indicate that the global establishment still possesses the ability to contain that threat, check Beijing's ambitions and persuade it to play according to the rules (*ibid.*).

Despite this evidence, it is worth reviewing Beijing's behaviour from a broader perspective. China's leaders could opt to intensify its involvement in the US-led World Bank or the Japan-led Asian Development Bank. Instead, China has preferred to lead the creation of alternative IFIs at the same time that it elevated criticism against the current global financial architecture. As Prasad (2017) argues, China is turning into a prominent player in the global community not as the West would like, by being co-opted into current structures under the existing rules, but on its own terms and by attracting other countries into the framework it wants to conduct. The broader picture thus suggests that China's agreement with other countries' demands within the AIIB only reflects the current balance of power, against which China sees itself as a potential challenger that is building up its capacity rather than a player ready for open confrontation.

It is expected, therefore, that Beijing will adopt a more assertive posture in the long term as China consolidates its position of leadership. As discussed in Section 3.1, China and its allies might not find it difficult to reach the 50 per cent vote shares necessary to approve the disbursement of loans in RMB. For a restricted number of issues, however, the AOA establishes a supermajority quorum of 75 per cent. While it is hard for Beijing to take for granted to achieve this quorum, it still has the 25 per cent necessary for the power of veto (AIIB, 2017a), granting it significant control over the AIIB's decisions.

Even in the NDB (a financial institution that emerged from a group of countries intending to change the global financial order), there is space for some kind of interference by the Bretton Woods Institutions. The Treaty for the Establishment of the CRA puts some conditions on the access to financial resources aimed at supporting member countries facing pressure on their balance of payments. In Article 5.d.II, the Treaty states that access to an amount superior to 30 per cent of what a country is able to borrow is subject to the existence of an on-track arrangement between the requesting member and the IMF involving ‘’a commitment of the IMF to provide financing to the Requesting Party based on conditionality, and the compliance of the Requesting Party with the terms and conditions of the arrangement” (Ministry of External Relations, Brazil – *BRICS*, 2014). These requirements have raised concerns that the NDB might enforce the current financial architecture rather than change it, particularly in what concerns the centrality of the dollar (Peruffo and Prates, 2016).

The requirement itself, however, is restricted to the hypothesis of financial support to face difficulties in the balance of payments rather than acting as a constraint on the disbursement of loans denominated in RMB. As mentioned in Section 3.1, NDB has already completed its first loan denominated in RMB. Therefore, if the US is to use its influence to block the RMB internationalisation agenda within the new IFIs, it would be more attainable in the AIIB. However, considering the high voting shares of the “would-be” challengers of the US dollar, this is not likely to happen.

4.2. Opposition from Chinese Economic and Political Groups

Apart from the presumable US opposition to RMB internationalisation, there are also internal debates in China that might push against it. The monetary reforms to pursue the macroeconomic conditions to a deeper currency internationalisation would undermine the Chinese Communist Party’s (CCP) political power (Eichengreen and Kawai, 2015: 10; Wheatley, 2013: 14) and cause side effects that might ultimately harm export sectors (Lim and Kim, 2017). On the other hand, RMB internationalisation is seen as a means to modernise the country’s rigid and ineffective financial sector and promote the efficiency of its monetary policy (Volz, 2014: 2).

As discussed above, Chinese authorities recognise that the internationalisation of the RMB requires wide and deep financial reforms, especially those that will liberalise the exchange rate, promote the openness of the capital account and free convertibility. The PBC has been affirming its commitment with exchange rate reform towards greater reliance on market forces, but still under a ‘’managed floating exchange rate regime based on market supply and demand’’ (People’s Bank of China, 2010). The abovementioned monetary policy has been implemented since July 2005 and it is deepened whenever the macroeconomic conditions are favourable to a further liberalisation without compromising China’s external trade and balance of payments (*ibid.*). As highlighted by the PBC 2016 report, Chinese monetary authority promoted the RMB internationalisation in a steady and well-sequenced manner, following the principle of better serving the real economy (The People’s Bank of China, 2016).

According to Eichengreen and Kawai (2015: 12), such mere basic capital account convertibility would be enough to enhance RMB’s international use for foreign trade and for financial transactions, but not for institutional investors and central banks to use it as a reserve asset. For the reforms to turn the Chinese currency liquid and make it trusted enough to attract the asset managers’ attention, monetary authorities would have to loosen some control over the financial markets and capital accounts (Wheatley, 2013: 14). These controls have, however, largely been used as tools to enhance China’s economic performance. The control of the exchange rate guarantees the Chinese industry extra protection against imports, as well as making it more competitive in its exports (World Bank, 2013). Artificially repressed interest rates have been used as an instrument to incentivise strategic sectors of the economy, keeping levels of economic activity and employment high, which is essential for the legitimacy of the CCP (Cohen, 2015: 235). By loosening the monetary controls, therefore, the ruling party would curtail its own means of macroeconomic management, which it has used to keep political power.

There are nevertheless risks of financial disruption followed by capital account liberalisation. Such risks proved particularly high in countries with weak financial markets and less well-developed regulatory institutions (Eichengreen and Kawai, 2015: 10). Although one of the long-term effects of currency internationalisation is the strengthening of macroeconomic flexibility (Cohen, 2012), the opening-up of China's capital account in the prevailing architecture, before improving financial markets efficiency, heightens the possibility of volatility and economic instability (Yu, 2014: 19; Eichengreen and Kawai, 2015: 2). Chinese commentators, indeed, recommend that Beijing keep close control on the exchange rate and capital flows in order to curb macro-financial risks while ensuring the smooth realization of RMB internationalisation (International Monetary Institute, Renmin University of China, 2017). Chinese authorities thus face a trade-off between financial market efficiency and control over the economy. Yet, taking the necessary steps towards a deeper currency internationalisation before adopting a market-oriented approach in the financial sector implies a problem of sequencing that can bring financial instability and increase the prospects of financial crisis.

As discussed above, one of the side effects of the mandatory reforms is to make the currency exchange rate more similar to the market rate. This shift will reduce Chinese exports competitivity as the opening of domestic financial markets to global investors with increasing appetite for RMB-denominated assets could introduce excessive appreciating expectations on Chinese currency (Xia, 2018). It would be a re-orientation of government priorities that, for a long period, have been stimulating export expansion and economic growth through currency depreciation (Lim and Kim, 2017; Cohen, 2015: 217). The powerful Chinese export sectors are likely to react to this shift and press for the maintenance of a controlled exchange rate that is more favourable to their exports. Although it does not influence the RMB internationalisation agenda within the AIIB and the NDB directly, it can result in additional pressure on the IFIs' leadership to not to take the measures aimed at increase RMB's international role.

The counterpoint to this is the fact that the necessary shifts to internationalise the RMB match with the desire of Chinese reformers to restructure the country's financial sector (Eichengreen and Kawai, 2015: 2; Cohen, 2015: 217). To keep the exchange rate undervalued, PBOC must keep interest rates low to avoid attracting foreign capital and intervene in the foreign exchange market through open market operations (Volz, 2014: 12). The fact that interest rates are artificially low makes deposit rates unattractive to households, which prefer investing in real estate, thus increasing the Chinese real estate bubble (*ibid.*). Besides that, PBOC's intervention through open market operations reinforces the accumulation of US dollars at a large cost to the Chinese treasury (*ibid.*). Moreover, Chinese authorities maintain that the RMB internationalisation is a long-term strategy aimed at resolving the systematic drawbacks under the existing global monetary system led by the US dollar and offering a Chinese solution in order to promote a more robust and fair global monetary system (E, 2018).

Therefore, as is frequently the case with reforms, the shifts on China's monetary system will put powerful stakeholders on opposite sides. Although the continuity of the prevailing system is more consistent with the CCP's pursuit of political stability, the recent movements indicate that Beijing will gradually relax monetary controls in favour of RMB internationalisation (Cohen, 2015: 217). In January 2018, for example, the PBC optimized policies for cross-border RMB business by simplifying cross-border RMB settlement by enterprises, facilitating foreign institutional investors to use the RMB for direct investment and promoting RMB business for individuals (E, 2018). Steps already taken towards currency internationalisation and the measures of the Chinese leadership aiming to enhance its international clout demonstrate that China is in firm pursuit of RMB internationalisation.

Given the central importance of political stability, however, it is reasonable to expect that this shift will occur slowly, without prejudice to economic growth. As argued by E Zhihuan (2018), "increasing RMB's proportion in global exchange reserves and foreign exchange market cannot be realized in a short period of time. Instead, it is necessary to explore from multiple perspectives, such as cross-border trade and investment, encouraging third-party usage, etc."

Time is in Beijing's favour in this case. Chinese industry is quickly moving from low-added value to being high technology-based (World Bank, 2013). As this shift consolidates, Chinese industry will reduce its dependence on the overvalued exchange rate, leaving room for further flexibility in its monetary policy and for advancing RMB internationalisation.

5. Conclusion

This paper has assessed the extent to which the AIIB and the NDB are part of China's strategy to turn the RMB into a major global reserve currency. The extraordinary economic performance of the last decades has elevated China to the status of second largest economy in the world. Recent movements in China's diplomacy indicates that the country is keen to transform its economic power into political influence. Beijing is aware that the internationalisation of the RMB is a crucial step towards global leadership, as it will increase its revenue via seigniorage and boost its influence over the international community. China's leading role in the AIIB and the NDB provides it with the opportunity to use the IFIs to support its own interests, including the internationalisation of the RMB.

The statutes of both Banks are suitable for promoting the internationalisation of the RMB through the disbursement of loans and the issuance of bonds denominated in yuan. The deployment of large-scale RMB-denominated loans overseas will popularise the currency internationally and, consequently, will create the necessary structure (such as RMB offshore centres and swap arrangements) to use it internationally. Even if the Banks do not manage to lend in RMB they will contribute to increasing the trade and investment flows between China and other members, which will eventually create new beachheads to internationalise the yuan. The provision of finance overseas has long been part of the Chinese foreign policy and RMB internationalisation strategy. However, the participation of the IFIs in this process provides legitimacy as recipient countries will not fear an excessive dependence on Chinese money. The issuance of RMB-denominated bonds, on the other hand, will diversify the financial asset portfolio in yuan, incentivising investors and central banks to hold it.

China's strategy, however, is likely to face resistance from the US and domestic industrial and political groups. The US, as the issuer of the main international reserve currency and fearing to lose the privileges granted by this status, might try to detain all China's initiatives aimed at the RMB internationalisation. Due to the composition of the voting shares in both Banks, however, there is little room for any American manoeuvre to succeed. Within China, some political groups and economic sectors might also resist the internationalisation of the RMB, motivated by the lack of political prestige and economic losses that might result from the flexible monetary policy that is necessary for RMB internationalisation.

The AIIB and the NDB are clearly part of China's strategy to internationalise the RMB. Given their capacity to deploy RMB on a large scale throughout the world, they are meant to play an important role in the process. Nonetheless, the main driver of the RMB internationalisation is the Chinese monetary policy. While it remains tightly controlled, the IFIs will only partially enhance the international role of the yuan. Therefore, the AIIB and the NDB will help promote RMB internationalisation, but their effectiveness will be limited by the pace of the flexibilisation of the Chinese monetary system.

Notes

* Rafael R. Codeço, MSc, is currently a Foreign Trade Analyst at the Ministry of Industry, Foreign Trade and Services, Brazil. He serves in the Department of International Negotiations of the Foreign Trade Secretariat. Rafael R. Codeço has studied Law in his undergraduate studies. During August – September of 2014 he has attended the 29th Academy of International Economic Affairs, organized by the Ministry of Economic Affairs, Taiwan, in Hsinchu, Taiwan, as a government official Brazilian guest. He was awarded a MSc in globalisation and development with merit from the School of Oriental and African Studies (SOAS), University of London, last year. The current paper is based on the research he has conducted during his MSc studies, which covered topics like multilateral banks, public banks and development; the Flying Geese pattern in the development of the Asian Newly Industrialized Countries; China's path to high-income status and its main threats and obstacles; the rise of emerging countries and the challenges to the US global hegemony; and the current trends of the International Monetary System. His current research interests

include China's economic development; the Chinese developmental state; the economic development of Asia-Pacific region; and China's emergence as a global power and its aspiration for hegemony. <*Email: 630039@alumni.soas.ac.uk*>

The views, thoughts, and opinions expressed in the text belong solely to the author, and not necessarily to the author's employer, organization, committee or other group or individual.

1. The terms RMB and yuan are used interchangeably as a designation of the Chinese currency.
2. Estimates indicate that seigniorage gains accounted for up to 3% of annual tax collection in the US (Jefferson, 1998).

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