



FOR PROFESSIONAL INVESTORS – 4 January 2023

Chi on China

THE RENMINBI'S CREEPING INTERNATIONALISATION (II): THE PETRO-YUAN AND THE ROLE OF GOLD

It does not matter how slowly you go as long as you do not stop.

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SUMMARY

- If Saudi Arabia decides to trade oil with China in renminbi, it would add momentum to the 'petro-yuan' trading already happening between China and Russia. More players choosing to trade oil and other products with China in renminbi could help yuan trading reach critical mass over time.
- Gold is a key element for building up the petro-yuan system. A gold-backed petro-yuan does not require full renminbi convertibility to function, so it allows China to simultaneously retain control of the capital account and boost the internationalisation of the renminbi.
- This system would enable the renminbi to become an independent asset class over time and deepen both the renminbi's internationalisation and China's onshore capital markets. It could also disrupt the USD-dominated SWIFT global payments system.

PETRO-YUAN'S MOMENTUM

President Xi Jinping visited Saudi Arabia last December during the first China-Arab States Summit and the China-Gulf Cooperation Council Summit. The state visit furthered China's 2018 initiative to shift more trade in oil to the renminbi from the US dollar.

Meanwhile, the US-led sanctions on Russia since the Ukraine war in February 2022 has boosted the already burgeoning Sino-Russian trade (Exhibit 1), prompting Russia to increase its usage of the renminbi and China's Cross-Border Interbank Payment System (CIPS) for oil trade to bypass the US-dollar dominated Society for Worldwide Interbank Financial Telecommunication (SWIFT).



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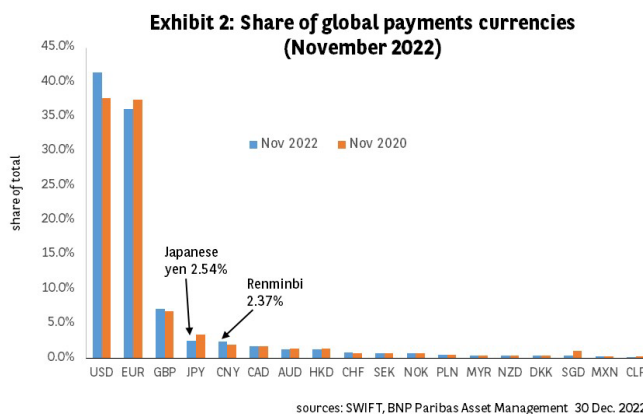
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As we argued earlier, if Saudi Arabia and Russia were to work further with China, the amount of renminbi-denominated oil trades going through the CIPS could rise sharply¹. Countries including Iran, Venezuela and Indonesia are already settling some of their China oil trades in renminbi. The volume, and the scope of using renminbi for international payments, could grow as more countries diversify out of US dollar risk. This development could challenge the US dollar-based global financial system over time as the dollar's global reserve currency status is largely based on its importance in the energy and commodity markets².

THE RMB'S CREEPING IMPORTANCE

Some market players initially estimated that switching the oil trade from the dollar to the renminbi could move transactions worth between USD 600 billion and USD 1 trillion out of the dollar a month³. SWIFT data show that the renminbi was the fifth most-widely-used global payments currency, accounting for 2.37% of the total in November 2022 (the latest data available at the time of writing). That was up from 2% two years ago, though still a fraction of payments in USD and EUR (Exhibit 2).



¹ Note that Russia's fourth largest oil producer, Gazprom Neft, has been settling all its crude oil sales (a third of its total oil sale) with China in renminbi since 2015.

² See "Chi on China: The Renminbi's Creeping Internationalisation: The Boiling Frog Fable", 13 April 2022 ([here](#))

³ For example, see "The Petro-yuan: A Momentous Game Changer for the Global Energy Markets, the Global Economy and Sanctions." By M. G. Salameh, International Association for Energy Economics, IAEE Energy Forum, Third Quarter 2018, pp.29 – pp.33.

With about USD 100 trillion worth of monthly payment messages moving through SWIFT, the renminbi's 2.37% would amount to about USD 2.37 trillion a month. Add to that amount the USD 600 billion to USD 1 trillion of oil trade that could be settled in renminbi, the yuan's share of global payments would rise to 3% or more in the SWIFT system. That would put the renminbi ahead of the Japanese yen as the fourth most-widely-used global currency, *ceteris paribus*.

GOLD'S ROLE

Of course, the petro-yuan will not displace the petro-dollar and the dollar-based payments system overnight. However, China's strategy to back renminbi oil trades by gold is instrumental for building up the petro-yuan system and, hence, challenging the US dollar hegemony. Making the renminbi convertible into gold effectively turns the currency into a global investable asset for foreign renminbi owners, boosting their confidence in and demand for the Chinese currency.

If such a strategy succeeds in getting Saudi Arabia and Russia to buy into the petro-yuan initiative, many other countries may follow. This could have profound geopolitical and economic implications as it would change the dynamics of the oil trade and could tilt the geopolitical balance towards China. Countries might be able to evade economic sanctions under the US dollar system by using the renminbi and CIPS, thus greatly weakening the US global surveillance ability and influence.

A RENMINBI ASSET CLASS

China is building the infrastructure for renminbi internationalisation. The petro-yuan system could allow it to accelerate the process while retaining full control of its capital account. Sustaining and growing the petro-yuan network also means that China would have to accumulate more gold for a gold-backed renminbi as an insurance for foreign investors and businesses to accept the currency.

Over time, however, China will need to create more yuan-denominated investible assets besides gold to increase the incentive to use the currency. Only when non-trade demand for renminbi rises can China speed up internationalisation⁴, and that will require China to further develop its onshore capital markets, including renminbi hedging instruments, to accommodate large foreign fund flows.

The renminbi is moving to become an asset class of its own over time rather than just being part of the emerging market assets.

Chi Lo, BNP Paribas Asset Management

⁴ "Chi on China: Renminbi Gran Turismo (Part 1 of 3): The Next Step for Internationalisation", 17 September 2014 ([here](#)).

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