# Issues Surrounding Internationalization of China's Currency

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*Recent global financial crisis has aggravated problems in the current world monetary system and has called US dollar's exorbitant privilege into serious question. There is a growing demand for a multicurrency world monetary system based on an increasingly multipolar world economy. In this context, the paper focuses on the issues of China's currency internationalization and analyzes it impacts, pros and cons, in the world monetary system in general and China in specific.*

## INTRODUCTION

China has become omnipresent in the world economy over the past three decades. Currently China exports and imports have reached $3.87 trillion level slightly ahead of American's $3.82 trillion. As the world's second largest economy, China is facing the inevitable process of internationalization of its currency (RMB). China's increasingly large economic activity and active role in world trades and investment have demanded RMB's international currency role. What does this mean for China and the world monetary system? To this end, this paper will address four questions in specific.

- Why internationalization of RMB matters?
- Is China up for the RMB internationalization challenge?
- What will be the ultimate benefits and costs of RMB internationalization for China and its firms?
- What are implications of RMB internationalization for world international monetary system in general and the US dollar monopoly in specific?

## WHY INTERNATIONALIZATION OF RMB MATTERS?

2008 world financial crisis deepens problems in the current global monetary system especially US$ as the world dominant reserve currency in the system. The "made in the US" financial crisis has raised serious doubt about the credibility of US$ and its exorbitant privilege. With unconventional monetary policy and quantitative ease (QE) phase 1, 2, & 3 in process, some seriously doubt that US' ability can ever fulfill its debt obligation. Further it is real attention to inflate its debt obligation around the world as US total public debt, which is more than $16.7 trillion, has exceeded its GDP. In other words America was perceived no longer be able to bear the world responsibility for its currency due to its own financial and economic performance, and its unsustainable debt level. This weakens the credibility of the dollar and its ability ever to pay back to its creditors. Countries around world questioned US$ has unfair advantage in lowering cost of its debt, in terms of financing cost, transaction cost, and ability to externalize its debt.

Russia Prime Minister then, Vladimir Putin, put it memorably when he accused United States of "living like parasites off the global economy and their monopoly of the dollar." (Eichengreen, 2012).

History told us the incumbency position of a world reserve currency cannot last forever and so does US dollar. Currently due to US$ incumbent position and lack of alternative currency, the dollar's world currency role remains solid and actually appreciated during the worse phase of the recent world financial crisis at the end of 2008. As the world economy recovers, some hope the noise around US$ may soon over. If history can be any guidance, the most recent world currency, British pounds was not long lived. Once Britain was the first world industrial power and the leading world trade nation, it once enjoyed more than 60 percent of the world trade. Sterling as the world currency then was used as the invoice currency, settled currency and reserve currency from later 19 century till early 20th century. Soon it was replaced with larger and stronger American economic power. By 1931 at its peak before the WWII, US$ accounted for more than 60 percent of official reserves of major central banks and governments (Eichengreen and Flandreau, 2009). The history shows that a country's share of global trade and investment determines the demand of its currency. At the same time, the development of its currency market determines the liquidity and convertibility of its currency as settlement currency and invoice currency.

With changing shares, as percentage of the world economy, among countries, there is a huge global imbalance among three types of economies. It leads to asymmetry of currency and trade flows. On one side of the world, we have financial and consumption driven US economy and welfare/entitlement burdened Western European states. On another side we have manufacture and production oriented economy, such as Germany, China, South Korea, Japan, and ASEAN countries. To support this, there is a resource oriented economy (land agricultural business and minerals/petro business), like Russia, Australia, Peru and so on. This has led to a huge trade imbalance in the world and shifted indebted status to Western countries. At the same time, it is accompanied by the rising economic power of emerging markets. As the world moves towards a multipolar economy, the imbalance and economic changes demand more alternative world currencies besides the US dollar.

Triffin paradox offers insight to the role of the US dollar. Triffin paradox is the conflict between the benefits and costs for a reserve currency country. The reserve-currency country enjoys the consumption benefit of running a large current account deficit, while the rest of the world benefits from the additional liquidity and helps facilitate trade. The cost ultimately comes from the declining credibility of reserve currency which runs a persistent trade deficit. Over time the dollar is strained more and more as ever than before. The US dollar monopoly and incumbency position may back fire. It could hold US hostage to its own currency if US cannot deliver solid economic performance in the future. Again if history can be any guidance, it is not because UK came out of WWI as a debt nation rather it has been its bad economic performance afterwards.

There has been a demand to create a world currency independent of any sovereignty or a world currency link to a basket of national currencies and key communities (Rogoff, 2001; Chen & Rogoff, 2003). In reality this seems not only remote and also not very practical in a perceivable future given the world current political infrastructure and the logistics of the world currency market, if one looks at the historical performance of SDR and the raising issues associated with SDR supporting Bretton Woods' institutions. In 2013, the establishment of BRICS Development Bank in South Africa has further highlighted these concerns. Does RMB have potential to be a good candidate to challenge the monopolistic position of the dollar? In this context, China currency along with others is demanded as an alternative for countries to diversify away from US$. Currently on the demand side for China RMB, more and more central banks approached People's Bank of China (PBoC) for currency swap (Fan, 2012). On the supply side, there is a restriction for trading Chinese currency because China's capital account is not open.

Currently China not only bears the rising cost to store its wealth in US dollars for its $3.3 trillion official reserve but also has had no bargaining power when it has to invoice its major imports and exports in the US dollars. Although China is the world largest importer of energy and minerals, one of reasons that China has no pricing power, subject to foreign exchange risks, and has to pay higher prices consistently are due to majority of the world resources and commodities are traded, invoiced and settled in the US dollar. Therefore it matters for China and the world that RMB has to be internationalized from both demand and supply sides.

## IS CHINA UP FOR RMB INTERNATIONALIZATION CHALLENGE?

### Current Status

China has not opened its capital account till now. As Japan in the past (Kwan, 2012; Itoh, 2009), China has been reluctant to open its capital account for good reasons. China has avoided world class financial catastrophe twice in 1997 and 2008 partially because it has not liberalized its capital account, has not internationalized RMB, and has kept the global hot money (short term capital flow) at bay. Now China is continuously to benefit from this. As US Fed wires down QE3, it has money to leave emerging markets and cause devaluation of local currencies and capital crunch. This created an opportunity for RMB to fill in the vacuum without suffering the instability of large scale of hot money in and out of China. Although China's capital account is not liberalized, the RMB has found its way outside China especially in the region. Market imperfection can induce "entrepreneurial" activities to circumvent rules. It has become increasingly difficult for the Chinese authorities to maintain capital account controls, as the economy is increasingly open and the offshore RMB market is rapidly developing. Companies have become increasingly creative in exploiting loopholes and gray areas in regulations to get funds and to arbitrage for higher-yield investments outside China. An increasingly transfer pricing activities made iPod priced like gold bars as evidenced by the recent exaggerated monetary value of electronic exports from Shenzhen to Hong Kong when the numbers of container shipment across Hong Kong and Mainland border remain almost constant (Economist, 2013a). "If this phenomenon continues to spread, it will not only distort macro data, but also make cross-border capital flows even more difficult to monitor, and potentially more harmful to macro stability" (Brace, 2013). Given this reality, very recently China adopted a series polices gradually internationalizing RMB.

According to 2013 the Bank for International Settlements (BIS), the RMB is the fastest growing currency in global foreign-exchange turnover. In contrast to 2001, RMB did not even register on the BIS ranking, accounting for less than 0.1% of all such transactions, but in the latest survey, published in September 2013, RMB had accounted for 2.2% of all foreign-exchange transactions (out of 200%, owing to the fact that each transaction involves two currencies). This ranked it as the ninth most commonly used currency. However RMB still lies behind currencies like Mexican peso and Canadian dollar. It has a long way to go before it matches even British pound, with 11.8% of transactions, let alone the US dollar's 87%.

Internationalization of RMB includes globalization and regionalization. At its infancy, recent trend indicates RMB is starting to regionalize (Fan, 2012). Regionalization of RMB is on the way although RMB globalization is yet to happen. Research (Subramanian and Kessler, 2012) shows that RMB's influence, measured by co-movement coefficient, has passed Japanese yen in the region since 2005. Regional RMB bloc seems start to take shape as China is the largest trading partners of its neighbors. 52 percent of China's trade occurred in neighboring Asia. Asia accounts for 78.6 percent of China offshore RMB settlement in 2012 (Jin, 2012). Globally China share of World nominal GDP increased from less than 2% (1978) to 11.5% in 2012 comparing with US 22% in 2012 according to World Bank data. In 2012 the total US exports and imports is $3.82 trillion, while for China is $3.87 trillion (Saigal, 2013a) mentioned earlier. Current account surplus and large official reserve of $3.2 trillion are also strong supports for RMB early stage of regionalization.

An international currency plays some or all three roles (Cohen, 2012): settlement currency (medium of exchange for international trade and investment transactions), invoice currency (as unit of account or anchor currency), and reserve currency (to store values/wealth). Three roles of RMB are analyzed in this context. Pease note by and large RMB has not yet to be an invoice currency in the region.

*RMB Used as a Settlement Currency*

The total cross board trade using RMB settlement has grown from ¥3.6 billion (2009) to ¥2.08 trillion (2011) increased 578 times in two years; and companies who are qualified to settle their cross board trade in RMB also has grown from 365 pilot companies (2009) to 67,724 firms (2010) increased 186 times (Fan, 2012). Firms in 206 countries are accepting payment in RMB for their international transactions (Sina Finance, 2013). 47 countries settled more than 10% of their payments with Hong Kong or China in RMB, with particularly widespread use of the currency in such transactions in South Korea, Taiwan, Singapore, the Philippines, France, the UAE and the UK (Economist, 2013b).

One of the factors driving rise tide in RMB-denominated trade is to lower the cost. "In the past, Chinese suppliers have typically needed to add a premium of 1% to 3% on to their US dollar quotes to hedge against unfavorable exchange rate movement before a trade settles," says Peter McIntyre, head of UK trade, HSBC (Brace, 2013). By transacting in RMB, companies might find their Chinese counterparties are willing to negotiate at the lower prices. A survey of Chinese companies trading internationally carried out by HSBC found 41% were willing to consider offering discounts up to 3% on RMB-denominated settlement. And 9% were willing to give even larger discounts (Brace, 2013). In addition, companies that are willing to transact with their Chinese trading partners in RMB might find they have access to a larger pool of potential China business counterparties, including smaller suppliers who might be unwilling to trade in the US dollar. As such, there is a strong incentive for companies outside of China to transact in RMB, although not all companies are prepared to make the move at this point. Besides many non-US firms, like UK and European firms, also have incentives to use RMB since using US dollar will expose them to additional foreign exchange risk.

*RMB Used as Investment Currency*

14 countries already diversed their investment in RMB denominated bonds issued by China. HK offshore RMB center has issued a large scale RBM denominated securities to lay the foundation for internationalization of RMB and to build its credit worth. ¥100 billion were issued in HK between 6/2007-11/2011.World Bank also issued RMB bond for the first time in HK since January 2011. Announced in December 2011, RMB Qualified Foreign Institutional Investors (R-QFII) allow their HK subsidiaries of Chinese fund companies and securities firms to re-invest RMB funds raised in HK back into China. As of the first quarter of 2012, China FDI (inward and outward) settled in RMB is ¥47 billion counted as 25.3% of total FDI, although outward direct investment is ¥2.87 billion or 2.76% of total FDI in the quarter (Jin, 2012).

*RMB Used as Reserve Currency*

Thailand, Malaysia, Cambodia, and Nigeria have announced to use RMB as their reserve currency. In April, 2013, the Reserve Bank of Australia announced it intends to invest 5% of its foreign currency reserves of AUD38.2 billion ($39.2 billion) in Chinese government bonds. The Reserve Bank of New Zealand is in negotiation with China to make its currency directly convertible with RMB. France has announced its interest in implementing a swap line with Beijing as well at time of this paper.

By 2013, China has signed currency swap agreement with central banks of 20 countries/regions. Per Sina Finance (2013) report, to promote international financial cooperation, gain financial security, and to reduce foreign exchange rate risks, China has signed bilateral currency swap agreements with 20 countries and regions in the amount of ¥2.2 trillion. In Asia-Pacific region, it includes South Korea, Hong Kong of China, Malaysia, Indonesia, Mongolia, Singapore, New Zealand, Uzbekistan, Kazakhstan, Thailand, Pakistan, United Arab Emirates, Australia; In Europe, it includes Belarus, Turkey, Iceland, Ukraine, United Kingdom; In Americas region, it includes Argentina and Brazil. For instance, China signed three year currency swap agreement with UK in the amount of ¥200 billion vs. £20 billion in June 2013 and with Brazil in the amount of ¥190 billion vs. reals 60 billion in March 2013.

*Offshore RMB Markets Also Start to Emerge*

HSBC has projected that RMB will be the third most-widely traded currency in the world as early as 2015, on par with the euro and the dollar. In 2013, RMB accounts for 12% of global trade but it has also been projected by HSBC that the currency will account for a third of all global trade in 2015 (Saigal, 2013a). As said earlier firms in 206 countries have accepting RMB payment. RMB offshore deposits also grow fast as a result, there are ¥700 billion in Hong Kong and ¥140 billion in Singapore by 2013, and in London it is ¥109 billion by January 2012. The total RMB offshore pool is estimated around ¥1.2 trillion where Hong Kong is the largest with ¥900 billion (Xinhua News Agency, 2013). At the beginning of 2013, Taiwan became the latest offshore clearing house for RMB. Singapore & London are also market for RMB deposits and spot market trading. The negotiation to be offshore clearing house for RMB in these two countries is also under the process at the time of this paper (Saigal, 2013a). Tokyo also trades RMB none delivery forward contracts (NDF) and yuan-yen direct exchange trading. Chicago CME also offers RMB NDF. In 2013, RMB deposits in France are the second-largest in Europe after the UK. Along with the offshore market development, the pace of RBM appreciation is accelerating. It hits 19-year highs against the dollar nearly every day. Since 2005, RMB has appreciated more than 30 percent against U.S. dollar.

*Free "Financial" Trade Zone*

In 2013, China established Shanghai Free-Trade Zone. At heart of this experimentation for the Zone is financial sector liberalization. This will be a testing window for internationalization RMB inside China territory and learning opportunity of setting up across boarder financial regulatory mechanism. It will allow trials and errors of market guided interest rate; allow firms to convert money more freely from yuan to foreign currencies, and move money overseas freely. Foreign firms inside the Zone will allow their foreign-exchange operations and may give them a bigger share of the domestic bond market. Domestic firms inside the Zone will have free access to global financial market as well.

## What Are Major Challenges for China?

In the context of the above positive development for RMB internationalization, there are many challenges because of its underdeveloped financial market, current global macroeconomic environment, and domestic economic development policy transition. These are analyzed in details below.

*Unstable Global Macroeconomic Environment & Domestic Policy Transition*

Globally uncertainty surrounding the unconventional US monetary policy of government security buying back program (QE1, 2, 3..), plus Euro-zone debt crisis, and Japan Abe's economic policy to boost country's debt to 240% its GDP in fighting decades of deflation. All these add uncertain liquidity to the global currency market and put pressure on emerging market currencies in general and China currency in specific. Although there has been a slowdown for US Fed T-bond buying program, the loose monetary policy activities of US Fed, ECB and Bank of Japan are yet to be settled. All these translate into additional uncertainties for the world monetary system.

On domestic front, China economic policy is in transition and leads to the slower growth in China market. Unusual higher growth in its financial sector relative to its real economy has raised concerns, according to China Bank Regulation Committee, China banking sector grows 39.3% while its industrial sector grows 25.4%, and its ROE has been higher than the most profitable state-owned tobacco and petro sectors (Zhang, 2012). After 2013 new leadership change, China is shifting from a high GDP growth economic development path towards more sustainable growth. China aims to shift its economic growth activities towards real economy other than paper returns from its financial and real estate sectors. It also plans to shift from export led growth to domestic consumption driven growth, and restructures the economic activities from high carbon manufacturing to low carbon productions. It will promote and support activities in sectors like service, IT, recycling or regenerating environmental friendly value added economic sectors. Facing challenges of economic/environmental unsustainability, increasing social inequality, and political corruption, policy makers always have stability in mind as precondition to go through these transitions. To this end, RMB internationalization has to be coordinated with the domestic economic, social, political, and environment policy priorities, especially for transition and upgrading for China large size of labor intensive export oriented sector.

*The Underdeveloped Financial Market Inside and Outside China Hinters RMB Denominated Securitization*

RMB is not a free exchange currency internationally, although recently policy measures and regulations are gradually introduced to internationalize RMB. Premature of China's domestic securities markets has yet to support RMB internationalization. China's debt and equity market are very small in comparing with that of the US. For its debt market in 2011, $3.3 trillion outstanding stock of debt securities issued domestically is very small in size, in contrast with $26.3 trillion of the U.S debt market. In addition, bond liquidity remains very low in China since most debt securities are held until maturity and never traded. For the equity market the capitalization of the Shanghai and Shenzhen stock exchanges is about 80 percent lower than the combined market capitalization of the New York Stock Exchange and NASDAQ Market. For the forward market, the RMB related foreign exchange derivative contracts is only 3% of the world total (Jin, 2012).

*Institutional & Policy Impediments*

China bank loans are still dictated or heavily influenced by administrative policy orders other than by economic efficiency, although in July, 2013 Chinese government has taken the initial step to liberalize its interest rate. State-owned enterprises usually have easier access to credit and more favorable loan terms than private enterprises in receiving loans from state-owned banks. The "big four" state-owned banks dominate the Chinese banking industry, and their too-big-to-fail status and explicit government support undermine market discipline. As of 2012, only 12% loans go to private SMEs (Zhang, 2012). During the world financial crisis, Chinese government stimulated its economy with a 4-trillion-yuan package, or about $585 billion, an intervention far more aggressive than that chosen by any other major economy, especially relative to China's GDP. Because of this usual liquidity in the economy and higher returns from financial activities, a majority of China leading manufacturing firms across industrial sectors are all involved in real estate investment and/or land deals. The extra liquidity has been diverted from real economy and gone to financial and housing sectors instead. Although inflationary pressures have eased following the PBOC's tightening monetary policy in the last two years, asset bubbles in the real estate market and mounting local government debt remain serious threats to China's financial outlook.

Large domestic shadow banking system is yet to be addressed as well. 4-trillion-yuan fiscal stimulus has led an explosion in off-balance-sheet lending by banks and private loans by nonbank entities. This shadow-banking lending activity accounted for an estimated 20 percent of China's total loans in 2011. With the cooling of the real estate market and with slower economic growth likely in the near term, a large share of these loans could turn bad. Because these loans took place outside the view of regulators, the effect of a sudden disruption in repayment is still difficult to predict.

*Weak Financial Market Regulatory Infrastructure*

Weak financial market regulatory infrastructure is way behind that of US and UK. It is under equipped to handle across board financial flows at the moment. In retrospect, China needs to take gradual steps to improve domestically financial market reform for efficiency, risk management, and internationalization. Note a recent change in policy shift may introduce more challenges. July of 2013 policy on liberalization of interest rate on bank loans is yet to be realized and carefully managed. It is better to be slow than fast and it is better to do it right than yield to global market pressures.

*Geographic Location and Territory Conflict Can Make RMB as an Unsafe Haven, and Economic Power along May Not Be Enough for RMB Internationalization*

Unlike British sterling in 19th century and US dollar in 21st century, they are supported by stable political system and strong military power while China only by its rising economic strength. Can this be possible and sustainable? For instance American can apply its military power if OPEC members do not conduct its oil trade in US dollars. Further China and Japan, China and South Asian territory conflicts could add unusual demand for US dollars and could make RMB as a safe haven impossible.

Time seems pushing RMB internationalization process at the faster speed although China is not ready. All above mentioned challenges will need time to work out before RMB can gain international currency status. In recent years, the net balance of capital and financial accounts has outpaced that of current account transactions, and has become the main source of China's reserves accumulation. This has not only put strong upward pressure on the RMB, but has also run a danger to create potential asset bubbles, particularly in the housing sector.

## WHAT ARE THE ULTIMATE COST AND BENEFIT OF RMB INTERNATIONALIZATION FOR CHINA AND ITS FIRMS?

What are ultimate pros and cons for RMB internationalization in light of above challenges?

### Liquidity Premium

RMB internationalization creates liquidity premium. Liquidity premium reduces China overall cost of borrowing. Due to an international increase in RMB demand, China can sell bonds at higher price (low yield) and buy bonds at lower price (higher yield). As more countries using RMB, it leads to a network effects in favor of China term of trade as trading partners pay and sell in RMB increase. It also enhances productivity and competitiveness for China companies years down the road. China manufacture firms can use its own currency abroad to reduce foreign exchange risk and lower cost of international trade. It enables Chinese firms to acquire overseas assets and advanced technologies. It facilitates firms industrial upgrading by allowing low value- added & labor intensive industries to relocate production to lower-cost countries (Saigal, 2013b). For Chinese financial intermediaries, RMB internationalization increases its volume and allows financial intermediaries increase profits from trading commissions, payment and investment services. Increase international demand for RMB leads its appreciation and increases purchase power for Chinese people travel abroad, increases China import, and reduces domestic inflation.

### Effects on China Economic Development

For trade account, the increase demand for RMB leads to appreciation of RMB and reduces competitiveness of Chinese firms. Since 50-60 percent of Chinese economy still relies on export and many of exporters are small firms, the impacts on China's low cost and labor intensive manufacture sectors are negative. Although China is changing its development model from "made in China" to "Create in China" and moving up to value chain, China still needs labor intensive sectors for a long time to absorb labors in the west region and rural area, and for a stable urbanization process to take place.

For the capital account, due to unfold Euro sovereignty debt problem, decrease US dollar credibility, and unsustainable growing US debt level as more than 100 percent of its GDP, it will not only puts upward pressure on RBM but also increase market volatility. Hot money would come to China for diversification and profit rather than real economic development. This can cause bubble and burst. Impatient capital flow is harmful for China development. Undeveloped China financial capital market can amplify the problem. for the impact on official reserve, as dependence on RMB increases as an international currency, it not only helps to increase China political power and importantly to reduce its dependence on the US dollar especially for its official reserve. It lowers cost for China to store its wealth ($3 trillion reserve) in US dollars and to diverse its risk away from US dollars.

### Triffin Dilemma

RMB role as a major world currency may require China to run a trade deficit if its capital account cannot meets RMB demand from foreign markets via capital account adjustment that is short selling and long investing.

### China Domestic Policy Independence

RMB internationalization will reduce China domestic policy autonomy and increase the challenge and reduce the control on monetary policy as increasingly RMB will be banked outside the country. It would be difficult to interfere and stabilize monetary aggregates and interest rates.

### It Helps to Increase China Political Power

When global dependence on RMB increases, it enhances China political power in the global affairs. Yet China geopolitics and regional conflicts can water down China status as a "safe haven" which adds volatility to RMB. An elite currency needs to be backed by political stability and strong military force to ensure peace and stability for a big country like China.

## WHAT ARE THE IMPLICATIONS OF RMB INTERNATIONALIZATION FOR WORLD MONETARY SYSTEM IN GENERAL AND THE US DOLLAR MONOPOLY IN SPECIFIC?

RMB internationalization helps to diverse foreign exchange risks in the global monetary system, to increase liquidity in the market, and to reduce transaction cost of only using one currency. It also allows countries to diverse away from US$ as settlement currency, invoice currency, and reserve currency. Adding RMB into the system will reduce the cost of capital and increase capital accumulation. Politically it democratizes the world monetary system and disciplines the western central banks and forces them to reduce deficits. It helps to improve international financial system stability and sustainability.

It reduces the US dollar role as the lender of the last resort and its ability by exchange real goods with costless notes. It would be especially true when a sovereignty independence world currency is too remote to accomplish and IMF/SDR is too weak to do anything at the moment. RMB acts as an additional hedge (diversification possibility) for global investors and to share power and responsibility. The current global monetary system gives US dollar unfair exorbitant advantages. It is not good for the world and not good for the US as well. The increasing role of RMB along with other emerging market currencies as alternatives in the global monetary system and declining role of US dollar may be inevitable in the long run. Yet how to get there and how long it takes to get there are still open questions. This will affect global monetary system and international business for years to come.

## CONCLUSION

For the determinants of international currencies, IMF researchers (Maziad, Farahmand, Wang, Segal and Ahmed, 2011) believe key determinants of currency internationalization are economic size, macroeconomic stability, deeper financial markets and macroeconomic and structural policies support. Based on historical perspective of US dollar (1913-1945), Deutsche mark (1973-1990), and Japanese yen (1948-1991), Harvard University scholar (Frankel, 2012) argued there are three determinants of international currency status, namely economic size, confidence in the currency, and depth of financial market. Based on econometrics analysis of recent central banks' official reserve (1967-2004), international trade settlement (1999-2005), and international debt securities (1993-2006), Chinese scholars from Tsinghua University (Li and Yi, 2010) identified there are five preconditions for an international currency: large share of a country's GDP to the world GDP, large scale of domestic financial market, large official reserve, continue appreciation of the currency for certain period of time, and convertibility of the currency. Specific for a reserve currency role, based on the history of British sterling and US dollar (Richards, 2011), two additional conditions seems required in addition to Li and Yi (2010) study – a stable political system of the country and military power in capable to intervene in the time of the regional and world crisis. Based on these seven conditions, so far RMB can only meet three out of seven, namely scale of the country economy, large official reserve, and continue RMB appreciation in the past eight years or so. Hence RMB has long way to go to be an international currency. The same case can be said for Euro. Till then, US dollar will be a world dominant currency in the world monetary system.

In a near future for the monopoly position of the US dollar, it will keep its world reserve currency position. As potential rivals for the US dollar, RMB currently is still under too many state restrictions. Further it may not be good for China and the world to internationalize RMB too fast; while euro on the other hand is a currency without a state backing as its weakness in the opposite side of RMB. What really challenges the US dollar, the same as in the past facing British pound, is the US itself. It is its own unsustainable debt and weak economy. With emerging of several strong players in the world market, the multiple currency system seems emerging. It may evolve into two tiers of international currencies system, namely the first tier of US$, Euro, and RMB and second tier of pound, Japanese yen, Swiss Franc, and so on. In a multipolar economy, we will be safer in a multicurrency world in the future though we may take a bumping road to get there.

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