China's renminbi – Russia's lifeline and leash

Western sanctions have increased Beijing's leverage over Moscow

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Russia and China will use whatever currency is "safe, efficient and credible" for their bilateral trade, said China's new Foreign Minister Qin Gang at a press conference last week.

He was responding to a question on whether the two countries would drop the US dollar and euro. From the perspective of both countries, this currency is the Chinese renminbi (RMB). For China, Russia's increasing use of the RMB is unambiguously positive. For Russia, though, the situation is far more complex.

Since its annexation of Crimea in 2014 and the US-led sanctions that followed, Russia has been gradually reducing its dependence on the US dollar. In 2017, US dollar investments were more than 40 per cent of its total foreign exchange reserves. A year later, Russia had reduced this US dollar exposure by almost half. The Russian central bank has stopped publishing details of its reserves after Russia's invasion of Ukraine, but US dollar usage by Russia has undoubtedly dropped much more in the past year.

The more severe sanctions put in place by the United States and its allies since the war have restricted Russia's access to the Swift banking system and effectively frozen half of Russian foreign exchange reserves, creating significant problems for Russia in its international trade and forcing it to reduce its dependence on the US dollar and euro.

Even before Mr Qin's statement, Russia's use of the RMB had risen dramatically. China is Russia's largest trading partner. In 2022, bilateral trade increased by 30 per cent to US$190 billion (S$255 billion). Prior to the invasion of Ukraine, RMB payments accounted for only 0.4 per cent of Russia's exports to China. By the third quarter of 2022, this share had shot up to 14 per cent. Rouble-RMB foreign exchange transactions on the Moscow Exchange, almost zero prior to the invasion, accounted for 48 per cent of foreign exchange trading by November 2022.

In December, the Russian Ministry of Finance doubled, to 60 per cent, the share of RMB that could be held by the country's sovereign wealth fund. It also stated that any future surpluses from oil and gas sales would also be saved in RMB.

Moscow is now the fourth-largest offshore trading centre for the RMB, after Hong Kong, London and Singapore, compared with a year ago when it was not even in the top 15. By early 2022, the last date for which data is available, about 17 per cent of Russian foreign exchange reserves had been invested in RMB assets. It is almost certain that RMB holdings have gone up further since.

Russia's de-dollarisation and increasing "yuanisation" are, therefore, both in full swing. Statements of the Russian government often contain references to "non-friendly" and "friendly" countries, based on who has or has not imposed sanctions. When it comes to a currency of a "friendly" country that it can use for international trade, the RMB is Russia's only seriously viable option, hence its increasing use.

From China's perspective, the more Russia uses the RMB, the better it is. China has had ambitions to internationalise the RMB for nearly two decades. Progress thus far, though steady, has been slow.

Predictions of the RMB rapidly posing a serious challenge to the dollar on the international stage have not yet been realised. Even as the RMB's role as an international currency is gradually growing, the US dollar continues to retain its dominance as the world's most international currency.

The RMB now constitutes 2.7 per cent of global foreign exchange reserves, was used for 2.2 per cent of global payments at the end of January 2023, and accounted for 7 per cent of all foreign currency trades in 2022. The corresponding shares of the US dollar are 60 per cent, 40 per cent, and 88 per cent. The RMB is now the fifth most widely used currency in the world, after the US dollar, the euro, the yen and the pound sterling.

Russia's need for a currency other than the US dollar or euro provides China with the perfect opportunity to increase the RMB's international standing. Russia using the RMB more is unambiguously good for China. Not so for Russia.

As long as the sanctions remain in place, with no serious alternatives, Russia's dependence on the RMB will continue to increase. Given the high commodity prices that Russia benefited from in 2022 and the resulting record export earnings, Russia must be grateful that it is able to use the RMB.

That said, Russia is no doubt fully aware that it is trading its US dollar dependence for RMB dependence. Russia was earlier exposed to the risk of US sanctions, which did come to pass. It is now increasingly exposed to risk from China's political preferences and economic policies.

Even though China is Russia's largest trading partner, trade with Russia forms only 3 per cent of China's total trade. For China, its trading relationships with the US and the European Union matter much more economically than its relationship with Russia. As the clear junior partner in the relationship, Russia will have to behave accordingly. In the context of a non-convertible RMB, China holds a very strong hand over Russia indeed.

China may have been that vital partner Russia needed to offset Western pressure, but in the process its RMB lifeline has increasingly become a leash.

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