

Eva Jancikova¹, Janka Pasztorova²

INTERNATIONALIZATION OF RENMINBI

The paper describes the process of internationalization of the Renminbi (RMB) and its position in international trade and financial markets. The aim of the article is to assess the prospects of turning Chinese currency (CNY – Yuan, measured by the value of RMB) into one of the reserve currencies. The growth of the multipolar world has led to an international re-evaluation of the USD's role as the world's dominant reserve currency – paving the way for the possible adoption of alternatives. In particular, banks all over the world are ready to realize transactions in Renminbi for their corporate clients.

Keywords: Renminbi; internationalization; international trade; reserve currency; USD.

Єва Янчикова, Янка Пашторова

ІНТЕРНАЦІОНАЛІЗАЦІЯ КИТАЙСЬКОГО ЮАНЮ (ЖЕНЬМІНЬБІ)

У статті описано процеси поступової інтернаціоналізації китайського юаню, його позиції у міжнародній торгівлі і на світових фінансових ринках. Оцінено перспективи того, що юань може стати резервною валютою, оскільки це є потенційно можливим в контексті становлення багатопольярного світу та переоцінювання ролі американського долару як домінуючої у світі валюти. Надано конкретні приклади того, як юань поступово виступає альтернативою долару, зокрема, для міжнародних банків та їх корпоративних клієнтів.

Ключові слова: юань (женьмінбї); інтернаціоналізація; міжнародна торгівля; резервна валюта; долар США.

Рис. 2. Табл. 3. Літ. 31.

Єва Янчикова, Янка Пашторова

ИНТЕРНАЦИОНАЛИЗАЦИЯ КИТАЙСКОГО ЮАНЯ (ЖЕНЬМИНЬБИ)

В статье описаны процессы постепенной интернационализации китайского юаня, его позиции в международной торговле и на мировых финансовых рынках. Дана оценка перспективам того, что юань может стать резервной валютой, что является потенциально возможным в контексте становления многополярного мира и переоценки роли американского доллара как доминирующей в мире валюты. Даны конкретные примеры того, как юань постепенно становится альтернативной доллару валютой, в частности, для международных банков и их корпоративных клиентов.

Ключевые слова: юань (женьминьби); интернационализация; международная торговля; резервная валюта; доллар США.

Introduction. After the high but unstable growth in the 1980s the violently suppressed demonstration on Tiananmen Square in 1989 was followed by an economic contraction caused mainly by the dissolution of the communist bloc and a period of international isolation. Deng's position began to be undermined by hard-line Maoists. At the beginning of 1992 Deng undertook his famous tour of Southern China to gather support for his development strategy. Inside the Communist Party he refused to discuss whether the nature of the reforms was socialist or capitalist (Buzinkai and Skvrnda, 2014).

¹ University of Economics in Bratislava, Slovakia.

² University of Economics in Bratislava, Slovakia.

China is the second largest economy in the world, the world's largest exporter and the second largest importer. The biggest challenge for its government is to ensure the sustainability of China's economic growth in accordance with 12 five-year plan at 7.5%. China is a member of major international organizations such as the UN, WTO, IBRD, IMF, World Bank etc. China's accession to WTO in 2001 was one of the most important steps in its contemporary history. The trade integration of China into the WTO contributed to increasing China's market share and negatively influenced the position of the main EU exporters (Fojtikova, 2012). China participates in the integration processes in the region, is a member of APEC, is deepening cooperation with ASEAN and is active in the organization of ASEM. It has free trade agreements with Singapore, Pakistan, Chile, Peru, Costa Rica, New Zealand, as well as with the ASEAN countries. Switzerland was the first from European countries to sign a free trade agreement with China after two years of negotiations. Negotiations on a free trade agreement are progressing well also with Japan, South Korea, Australia, Norway and Iceland. Some EU countries are also considering the advantages of such an agreement and some political leaders openly speak out that it is necessary to start negotiations on this issue. Interesting is the attitude of individual countries on the issue of granting the market economy status to China. Some countries like Brazil, New Zealand and Argentina have already acknowledged this status of China. We can agree with A. Fabian (2014), that China will be one of the most important business partners also for Central and Eastern Europe countries. There are many factors that can influence the future trade volumes: the world economy, world political situations, domestic economies and domestic policies.

China is dynamically activating in the EU, as evidenced by the activities of China Development Bank. We also see that the economic level of China continues to grow rapidly, China has a surplus in the trade balance and keep growing its foreign exchange reserves (focusing on USD) (Pawera, Skvrnda and Weiss, 2008).

In terms of international cooperation, China applies the principles stemming from the so-called "Five Principles of Peaceful Co-Existence", including the following (Erbenova, 2014):

1. Mutual respect for sovereignty and territorial integrity.
2. Mutual non-aggression.
3. Non-interference in internal affairs.
4. Equality and mutual benefit.
5. Peaceful co-existence.

The use of Chinese currency Renminbi for many years lagged behind China's economic development. It was caused by the restrictions applied in China. The paper deals with the process of Renminbi internationalization which started by China's accession to the WTO, but significant progress was mainly achieved in 2009.

Basics of Renminbi internationalization. Renminbi is the official name of Chinese currency, standing for "people's currency" and Yuan is a unit of currency. Chinese currency has several subvariants:

- CNY – Chinese Yuan (onshore) – the currency used within the mainland of China, only official ISO code of Chinese currency;
- CNH – Chinese Yuan (offshore) – the currency used outside the mainland of China, has its own rate, currently very close to the Renminbi exchange rate, but in the future may be different.

Start of Renminbi internationalization can be linked to China's accession to the WTO, which was the culmination of 15 years effort that started after signing up for membership in 1986. China became the 143rd WTO member on 11th of December 2001. The results of regression analysis carried out by (Fojtikova and Kovarova, 2014) confirmed that China's accession to the WTO had a positive and significant influence on China's foreign direct investments inflows. WTO membership helped further economic growth, mainly the reforms in governance and legislation. Chinese government has launched a campaign to clarify and unify government regulations, to meet the WTO demands. In the first half of 2002, the State Council of China canceled or amended 2300 regulations of 30 ministries. This process continues until now.

SWIFT (Society for Worldwide Interbank Financial Communication) deals with the issue of Renminbi internationalization. They are following the development in RMB transactions for several years and work with global banks on the analysis concerning the RMB use in trade finance, international payments or at financial markets. In 2011, the first document called White paper (SWIFT 2011) and titled "RMB internationalization: Implication for the global financial industry" pointed out that Chinese currency in international relations is underused as compared with the achievements made by Chinese economy. The main cause can be that the domestic capital market in China was relatively closed for foreign investors till 2002. The situation fundamentally changed in June 2010 when it became possible anywhere in the world to realize settlements of payment in RMB. We can consider that as the beginning of the RMB internationalization. Chinese and non-Chinese banks involved in global trade with China can now reap the benefits provided with the internationalization of RMB. Chinese banks see it as a strategic opportunity to follow their clients abroad and develop the clearing of their international payments. Non-Chinese banks see a great possibility for foreign companies to trade, pay and invest in RMB.

More and more financial institutions have on the agenda the question of the impact of the RMB internationalization on their business. "RMBfication" has become a part of strategy for most global banks. RMB internationalization path can be divided into 3 stages:

- 1) use of RMB in trade finance;
- 2) use of RMB in investment;
- 3) use RMB as a reserve currency.

Decline in deposits in Hong Kong indicates a move to RMB investment products. Although Hong Kong is still the largest offshore center for client deposits, a large increase occurred in other financial centers such as Singapore, United Kingdom, as well as Germany, France and other countries. According to the SWIFT report, RMB business affects 1050 financial institutions in 90 countries.

The internationalization of RMB has several dimensions. Internationally used currency is the basis for financial and commercial transactions, while serving as a store of value. Eichengreen and some other economists suppose in this regard, that if China realizes the necessary reforms of the domestic financial system and financial account, the RMB may take a role of globally used currency.

The world's currency, however, still binds the third dimension. It works as a reference point for other currencies. Such reference currency shows a large degree of common movement with the rates of other currencies. The overview of Asian curren-

cies shows that in 2005–2008 6 out of 10 these currencies responded to movements of USD rather than of RMB. After July 2010, however, this relationship changed and now there are 7 currencies of 10 more connected with RMB (Indonesia, Korea, Malaysia, the Philippines, Taiwan, Singapore and Thailand) (Subramanian and Kessler, 2013).

In this sense we can say that East Asia is now essentially a new currency bloc. The rest of the world is still dominated by USD, but the growing influence of RMB is evident. RMB begins to move like the currency in India, Chile and South Africa. The main reason behind is the growing trade. Countries with significant business ties with China will naturally try to stabilize the exchange rate of its currency with RMB.

The growing importance of RMB is different from that of Japanese Yen (JPY). JPY was never considered as a reference currency. We can expect that trade ties with China will continue to strengthen. If we take into account the lower growth of Chinese economy, RMB will become the dominant reference currency in about 25 years. This process can be significantly accelerated by the implementation of the necessary reforms.

Historical steps in Renminbi internationalization. The currency international status is based on 3 fundamental pillars. The first is the size of home economy, as measured by GDP or trade. The second is confidence in the value of a currency, measured by the long-term trend in its exchange rate, variability of the exchange rate, country's long-term inflation rate, and position as an international creditor. The third is the development of its financial markets, particularly depth, liquidity, dependability and openness (Frankel, 2012).

It used to be thought that international status of a currency is subject to much apathy (Krugman, 1984). Historically, there was a long time lag between the period when the US economy became larger than UK economy in size (1872, by the criterion of GNP). Furthermore, when USD passed the pound (1946, by the criterion of shares in central banks' holdings of reserves) (RIETI, 2015). This idea received more attention in the works of Eichengreen (2011). He figured out that the lag was in fact shorter than it was thought before. It took until World War I for the dollar to fulfill the criterion of the international currency. And the date when USD is said to have come to rival the pound as an international currency has now been moved up to the mid-1920s. The first point is right. If trade is the measure of size, the US first caught up with the UK during World War I (Eichengreen and Flandreau, 2010).

Taking in to the account evolution of US dollar as a international currency, Chinese currency has begun to internationalize just in the last few years. The RMB bond market has grown rapidly in Hong Kong. At the same time RMB is starting to be used to invoice some of China's international trade together with swap contracts. Foreign central banks have been able to hold RMB since August 2010. Malaysia became a pioneer in these operations.

Could China's currency now be in the same position as the USD at the time of the World War I? Could RMB make a rapid ascent and even rival the position of the internationally leading currency? Subramanian (2011a; 2011b) concluded that the Renminbi might overtake the dollar around 2022. He used the econometric approach with the reserve data back to 1900, with a gap between 1929 and 1958. Such analyses

are based on the calculation at current growth rates. He concluded that Chinese economy may overtake the US economy within a decade, even by the GDP criterion for size (this is already happened based on the last IMF annual report), let alone by the trade criterion. Another key point with this conclusion is the potential rate of return. Everyone believes that RMB would appreciate against USD in the long run. China is a creditor and is still running large surpluses while the US is a debtor and is still running large deficits (Frankel, 2012).

But the third condition for international currency status is obviously missing: deep, liquid and open capital markets.

From one side, the following are true:

- China is starting to use RMB in international trade.
- Foreign central banks have been able to hold RMB since August 2010 (Malaysia's went first, buying RMB bonds for its FX reserves, in September 2010).
- The RMB market is now developing in Hong Kong. Between 2007 and 2010, 62 bln RMB of RMB bonds (27 batches) were issued offshore including those by McDonald's. The Bank of China Hong Kong launched the RMB bond index on December 31, 2010.
- In November 2010, RMB deposits in Hong Kong reached 280 bln RMB.
- China opened the RMB swap market (the total amount of swaps exceed 3 trln RMB in 2013).

On the other side, the following are also true:

- RMB bonds and deposits in Hong Kong are small as a fraction of total RMB bonds and deposits (and of course, Hong Kong is still a part of China).
- Development of China's domestic financial market has just begun.
- It is still very highly regulated, and the domestic system is "financially repressed".
- Cross-border capital flows are subject to heavy controls. Foreign companies still cannot borrow in the mainland China.

Current Status of Renminbi. According to the records of SWIFT, RMB reached in October 2013 the share of 8.66% in trade finance activities – the letter of credit and documentary collections transactions. RMB overtook the EUR and got to the second place behind USD with the market share of 81.08%. In January 2012, RMB was still in the fourth place with the share of 1.88%. For 22 months it increased its share by 6.77%. The first position of USD cannot be threatened, but in the coming years we can expect that the share of RMB will grow rapidly.

The position of RMB in trade finance is given by a significant share of trade finance products in China's foreign trade. A letter of credit is still one of the most used means of payment, although recently due to the increase of open account payment condition in the supply chain financing we can see the decrease in the volumes of traditional trade finance instruments. We can therefore expect the increase of the RMB share as a payment currency.

An interesting phenomenon can be observed that among the countries using RMB in their trade finance are not only countries in the region, but also Germany. 5 countries that use RMB in their trade finance the most include China, Hong Kong, Singapore, Germany and Australia.

Table 1. RMB as the world trade finance currency in value (SWIFT)

JAN 2012			OCT 2013		
1.	USD	84.96%	1.	USD	81.08%
2.	EUR	7.87%	2.	CNY	8.66%
3.	JPY	1.94%	3.	EUR	6.64%
4.	CNY	1.89%	4.	JPY	1.36%
5.	AED	0.76%	5.	SAR	0.33%
6.	SAR	0.48%	6.	AED	0.26%
7.	GBP	0.38%	7.	CHF	0.26%
8.	KRW	0.21%	8.	GBP	0.25%
9.	AUD	0.18%	9.	PKR	0.17%
10.	HKD	0.16%	10.	IDR	0.14%

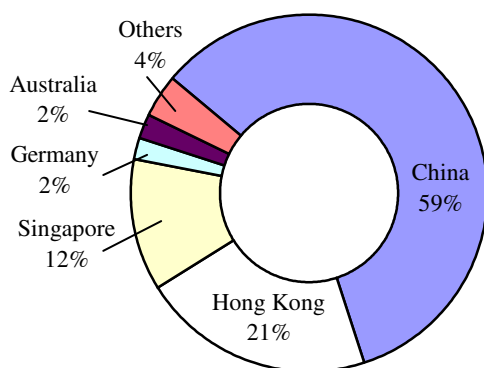


Figure 1. Top-5 countries using RMB for trade finance, October 2013 (SWIFT)

RMB remains the stable twelfth most widely used currency in international payments, maintaining the share of 0.84%. We expect that within a few months it gets into the top ten of the world's payment currencies.

RMB is the 8th most traded currency in the world. In January 2012, RMB was still at 11th place with 0.92% and in August 2013 it got to the 8th place with 1.49%. We can expect that if RMB continues its ongoing trend at the end of 2015 it can be in top-5 most traded currencies of the world. SWIFT monitors the trading of currencies by monitoring the forex transactions. Regarding trading currencies, we can see that the differences are not as significant as in the payments and trade finance. USD retains its first position in international trade as a result of the status it has built up after the World War II.

In Figure 2, we can see the countries (offshore centers), which have the largest shares in trading RMB outside China and Hong Kong. The largest share belongs to Great Britain with 62% of the London financial market. The other four countries are the USA, France, Singapore and Switzerland, all having shares roughly around 10%.

The use of RMB as an Investment Currency. The role of RMB in international trade has been growing in recent years; non-Chinese entities outside China tend to convert their RMB into USD or their home currency. In order to induce non-resident entities and individuals outside China to hold funds denominated in RMB, these parties need access to a wide range of RMB-denominated investment options. The

stimulus to create and further develop a wider variety of RMB financial products is greater than ever.

Table 2. RMB as the world payment currency in value (SWIFT)

JAN 2012			OCT 2013		
1.	EUR	44.04%	1.	USD	38.12%
2.	USD	29.73%	2.	EUR	34.69%
3.	GBP	9.00%	3.	GBP	9.92%
4.	JPY	2.48%	4.	JPY	2.56%
5.	AUD	2.08%	5.	AUD	1.91%
6.	CAD	1.81%	6.	CAD	1.89%
7.	CHF	1.36%	7.	CHF	1.72%
8.	SEK	1.05%	8.	HKD	1.02%
9.	SGD	1.03%	9.	SGD	1.01%
10.	HKD	0.95%	10.	SEK	0.99%
11.	NOK	0.93%	11.	THB	0.84%
12.	THB	0.82%	12.	CNY	0.84%
13.	DKK	0.54%	13.	NOK	0.83%
14.	RUB	0.52%	14.	PLN	0.58%
15.	ZAR	0.48%	15.	RUB	0.51%
16.	HUF	0.34%	16.	DKK	0.50%
17.	NZD	0.33%	17.	ZAR	0.44%
18.	MXN	0.31%	18.	MXN	0.39%
19.	TRY	0.27%	19.	NZD	0.38%
20.	CNY	0.25%	20.	TRY	0.29%

Table 3. RMB as the world traded currency in value (SWIFT)

JAN 2012			OCT 2013		
1.	USD	45.73%	1.	USD	40.14%
2.	EUR	17.21%	2.	EUR	16.16%
3.	JPY	6.48%	3.	GBP	11.31%
4.	GBP	5.84%	4.	JPY	5.78%
5.	AUD	3.77%	5.	AUD	3.21%
6.	CHF	2.69%	6.	CHF	2.34%
7.	CAD	2.40%	7.	CAD	1.99%
8.	SEK	1.58%	8.	CNY	1.49%
9.	KRW	1.08%	9.	RUB	1.16%
10.	RUB	0.98%	10.	KRW	0.86%
11.	CNY	0.92%	11.	HKD	0.76%

The global use of RMB has shown exponential growth. Offshore, the total RMB assets across four major financial centers (Hong Kong, Singapore, Taiwan, London) – including deposits, certificates of deposits (CDs), bonds, and loans – reached 1.88 trln RMB by the end of 2013, from virtually zero which was 4 years ago (Thomson Reuters, 2013). Outstanding offshore RMB bonds and CDs reached 634 bln RMB by February 2014, and are likely to reach 750–800 bln RMB by the end of the year (Thomson Reuters, 2014). Just 3 years after its launch, the size of the RMB market is reaching parity with certain regional markets, including the Philippines peso bond market and the Japanese Samurai bond market.

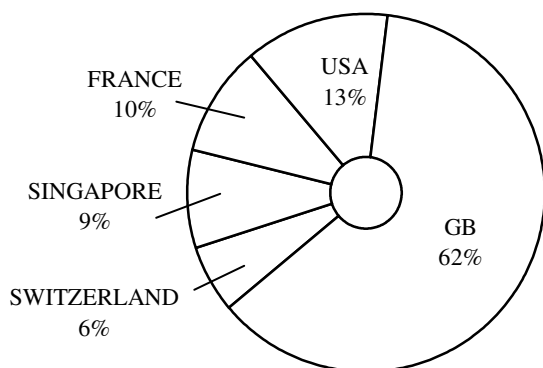


Figure 2. Top-5 countries trading RMB in 2013 (SWIFT)

Onshore, China's domestic markets have become more accessible to foreign investors – by the end of 2013, the total of 1 trln RMB in investment quotas had been approved for foreign investors' onshore investments. Foreign ownership of China's domestic market is expected to reach 3–5% by the end of 2014, from less than 1% a year ago (Standard Chartered, 2014). On the back of accelerating financial reforms, China's capital account is expected to become open by 2020 (Reports.standardchartered.com, 2014).

Strong growth momentum should continue, underpinned by the rapid development of new offshore centers, the broadening and improvement of cross-border remittance channels, and a likely sharp increase in capital raising by Chinese entities amid tighter onshore credit conditions (Reports.standardchartered.com, 2014).

- Total outstanding amount of key offshore products is expected to increase by at least 40% to over 2.5 trln RMB this year.

- Offshore RMB deposits are anticipated to reach 1.8 trln RMB this year.

- Total outstanding amount of offshore RMB bonds and CDs may exceed 750 bln RMB, likely reaching 800 bln RMB (Reports.standardchartered.com, 2014) in 2014.

The onshore market is also opening up quickly. China's domestic markets have become more accessible than many had expected. The total approved onshore investment quota for offshore investors under the 3 existing programs comfortably exceeds the total outstanding amount of offshore RMB bonds. Total onshore quota surpassed 1 trln RMB by the end of 2013 – well in excess of outstanding offshore RMB bonds and CDs, which stood at 572 bln RMB.

RMB use as a reserve currency. The terms «vehicle currency» and «global payment currency», in our opinion, are synonymous and indicate a some national currency serves as a measure of value and international means of payment, especially when it is not the national currency for importers or exporters.

Can Chinese Yuan meet these requirements? On the one hand, the share of RMB in international payments is growing. Thus, according to SWIFT data, the share of RMB in international payments has doubled – from 0.63% in January 2013 to 1.55% in June 2014 (SWIFT, 2014). Yuan thus climbed to the 7th place in the Table of Ranks Swiss franc. However, the increase of the Yuan share in international payments is primarily due to the fact that China (including Hong Kong) is more using

Yuan in international payments. Yuan is now the second only to USD currencies in being most frequently used for cross-border payments with China and Hong Kong. In May 2014, 12% of all cross-border payments in China and Hong Kong have been carried out with Yuan, 36% up as compared to the last year. At the same time, the share of Yuan in the transactions with the Middle East and Latin America exceeded 50%. In addition, in international payments, where China (including Hong Kong) is not a party in calculations, Yuan is used only in 8% of cases (SWIFT, 2011b), and therefore it is in the full sense the «vehicle currency».

What prevents Yuan from becoming a fully «vehicle currency»? Technically, the answer is quite simple: the Chinese Yuan should become a party to the international system of currency conversion operations CLS, which today covers 17 freely convertible currencies. We believe that opening in 2013 the CLS office in Hong Kong is one of the steps in this direction (the Bank of China has been a full shareholder in the system). Is there an economic potential for this? To answer this question, it is necessary to compare the share of China in the world trade and the world GDP with a share of RMB in international payments. If at the beginning of 2013, Chinese Yuan accounted for 0.63% in the international payments, the share of China in world trade accounted for 11.6%, while the world GDP – 9.5%, indicating a high potential for RMB internationalization. In comparison, such currencies as CHF, EUR, USD and GBP are used far beyond their share in the world trade and GDP.

Today, only two currencies – the USD and EUR – fully meet the concept of "global reserve currency". What are the prospects for RMB to become the new "global reserve currency"? The prerequisites for becoming a global reserve currency are:

- A large amount of GDP and foreign trade turnover of the issuing country. Gross domestic product and its share in global trade and financial systems are important but not decisive factors for obtaining the status of a reserve currency.

- A well-developed financial system and capital account openness. Currency should be acceptable for both trade and investment transactions. This means that the country should have liquid financial markets (primarily government bonds market) with large volumes and the number of buyers and sellers. This is difficult to achieve if the country imposes restrictions on capital flows.

- Trust in the setting mechanism and exchange rate stability. Course reserve currency should be determined by the market rather than established by the state authorities, although this does not exclude the active role of the central bank at the foreign exchange market. In addition, holders of a reserve currency must have faith in the macroeconomic stability of the issuing country, and the country should pursue a policy of low inflation and sustainable public debt in order to protect the value of its currency against erosion.

- Development of institutional arrangements for external accounts in that currency. The country should become a member of global clearing systems, or create your own clearing mechanism currencies and securities.

Political stability. Democratic election procedures limit the arbitrariness of executive power and is the best guarantor of the country's commitments that are essential for the functioning of stable and liquid financial markets.

The first prerequisite for China is no problem. China has sufficient macroeconomic potential for its currency to gain the status of the "global reserve currency",

argues one. Nevertheless, China has quite serious problems with the implementation of the remaining conditions.

Conclusion. Summarizing the ascent of RMB as an international currency by the criteria of liquidity, breadth, and openness, Chinese financial markets still have a long way of development before they will reach the main goal and will be able to compete with other major currencies. For this reason, the Renminbi in 2010–2011 only began to act as an international currency.

The Beijing government since 2010 has deliberately pursued offshore international use of the currency. In principle, it could accelerate the financial market development necessary to realize this goal.

Although the internationalization of RMB began with China's accession to the WTO, the actual development occurred in 2009. 5 years later, RMB has developed the second most used currency in international trade finance, 12th currencies in international payments and 8th currency trading at financial markets.

The next step is the increased global acceptance and usage of RMB as a settlement currency for trade purposes – the world should gradually transition away from USD as the "de facto" trade settlement currency, given China's role as the leading global trading economy. Increased invoicing of both imports and exports in RMB, also a process well under way, will have the dual advantage of 1) reducing the accumulation of USD reserves, a necessary step for global rebalancing; 2) commensurately increasing the role of RMB in global trade. This also has the added benefit of reducing exchange rate risks for both importers and exporters.

The final step in the evolution of RMB's role as a global currency is its global acceptance as a reserve currency. While there are clear indications that RMB is on the way to being a "de facto" reserve currency – with a number of central banks already holding at least some RMB as reserves – the fact remains that RMB still accounts for less than 1% of the global reserves and moreover is not formally recognized as a reserve currency by the IMF.

We expect that in the coming years, Chinese economy will become the strongest economy in the world and it will correspond to the position of its currency. RMB internationalization is on the one hand the result of the reforms in China, but at the same time we can also say that the RMB internationalization greatly helps this process.

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Стаття надійшла до редакції 11.03.2015.