

THE INTERNATIONALISATION OF YUAN: IMPLICATIONS FOR PAKISTAN'S ECONOMY

Azhar Zeeshan

Nida Khattak

Centre for Aerospace & Security Studies Lahore

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ABSTRACT

The internationalisation of the Chinese Yuan has been a significant global economic development since 2010. As China's second-largest economy in the world continues to expand, the Yuan's global role has evolved, marked by an increasing use in global payments and trade finance. The drive toward Yuan's internationalisation is shaped by China's strategic efforts to expand its financial market. However, this process is set to encounter persistent challenges, particularly due to structural limitations within China's economy, such as capital controls and the lack of a fully convertible currency. While on one hand, these barriers seem to limit the Yuan's appeal as a dominant global reserve and investment currency, its role in global trade is growing nonetheless. This, in turn, generates debate about the Yuan's projected internationalisation trajectory and its impact on the global economic landscape.

Within this context, this paper aims to assess the current status of Yuan's internationalisation, predict its future trajectory, and examine its potential implications for Pakistan's economy. Through an in-depth qualitative analysis of secondary data present in academic literature and policy reports, the paper seeks to answer two central questions, first regarding the current status of Yuan's internationalisation and the possible implications of Yuan's internationalisation for Pakistan's economy. By analysing the opportunities and challenges presented by a more internationalised Yuan, this study provides valuable insights for policymakers and businesses in Pakistan, considering the evolving role of China in the international monetary system.

Keywords: Yuan, Renminbi, Yuan internationalisation, Currency, Pakistan Economy.

1. INTRODUCTION

China's push towards making the Yuan an international currency can be traced back to the year 2010. Since then, the internationalisation drive has gained momentum owing to China's relentless efforts to boost the process of Yuan/ Renminbi internationalisation mainly through currency swap agreements with several countries and many other initiatives. However, this journey of the Yuan's internationalisation has not been linear and is characterised by persistent challenges and obstacles that continue to shape its trajectory.

For the purpose of this study the terms Yuan and Renminbi both terms for the Chinese currency shall be used interchangeably. The internationalisation trajectory of the Yuan has attracted the attention of many scholars, academics, practitioners, and international institutions since at least the year 2010. The concerned interest in RMB internationalisation has resulted in volumes of work of various natures including, but not limited to, books, research papers, working papers, white papers, policy documents, and opinion articles.

This working paper attempts to contribute to the existing corpus of literature on Yuan internationalisation by discussing the current status of Yuan's internationalisation and exploring the possible implications of the Yuan's internationalisation for Pakistan's economy. In doing so, the paper aims to answer two key research questions:

1. What is the current status of Yuan's internationalisation?

2. What are the possible implications of Yuan's internationalisation for Pakistan's economy?

To pursue these questions, the paper has adopted a qualitative methodology of research for which data mainly of secondary nature have been sourced from various sources mostly including quantitative datasets from international bodies such as the International Monetary Fund (IMF), Society for Worldwide Interbank Financial Telecommunication (SWIFT), and the government of Pakistan.

Additionally, it also encompasses research papers published in reputable journals, books, working papers, and white papers from bodies such as the Asian Development Bank (ADB), SWIFT, and IMF, as well as articles from newspapers and magazines. The data gathered from the sources mentioned above are then subjected to qualitative content analysis to make sense of the patterns and trends regarding Yuan's internationalisation and its implications for Pakistan's economy.

The paper is mainly divided into two parts. The first part primarily focuses on the internationalisation of the Yuan. It provides a detailed overview of the current status of Yuan internationalisation, focusing specifically on developments from 2022 onwards. It allows to confine the scope of the paper to more recent data and provide insights from an in-depth analysis of extensive literature that already covers the time period before 2021. The second part then goes on to examine the potential implications of Yuan internationalisation for Pakistan's economy by discussing key macro-economic indicators.

2. WHAT IS AN INTERNATIONAL CURRENCY

Any discussion related to the internationalisation of a particular currency needs to be preceded by a basic understanding of what exactly international currency is. According to Kenen, an international currency refers to a currency that is used and held beyond the borders of the issuing country, not merely for transactions with that country's residents but also, and importantly, for transactions between non-residents.¹

The functions of an international currency are many but the most basic are two: a store of value, and a medium of exchange. Simply, when an international currency is used as a reserve currency, it serves the function of a store of value by maintaining its monetary worth over time, which, in turn is essential for countries' foreign exchange reserves. Likewise, when it is used in global trade and finance, it serves the function of being a medium of exchange, thus facilitating global trade and finance.²

These functions are important and relevant in the context of this paper, especially, the first two as they will be used as a reference point to assess the current status of Yuan internationalisation which is defined as the process of the Yuan performing the functions of an international currency.³

¹ Peter B. Kenen, "Currency Internationalization: An Overview" (paper presented at the BoK/BIS Seminar on Currency Internationalization: Lessons from the Global Financial Crisis and Prospects for the Future in Asia and the Pacific, Seoul, March 19–20, 2009).

² Menzie Chinn and Jeffrey Frankel, *Will the Euro Eventually Surpass the Dollar as the Leading International Reserve Currency?* NBER Working Paper No. 11510 (Cambridge, MA: National Bureau of Economic Research, 2005).

³ International Monetary Institute, *Internationalization of the RMB: Establishment and Development of RMB Offshore Markets*, 1st edition (New York: Routledge, 2016).

3. CURRENT STATUS OF YUAN INTERNATIONALISATION

The internationalisation of the Yuan began in 2010 after the 2008 global financial crisis.⁴ Since then, this journey of internationalisation has been anything but linear with many ups and downs influenced by numerous factors which will be discussed later on.

To provide a summary, since 2023, the international use of the Renminbi has increased as far as the functions of international payments and funding are concerned. However, regarding its function as an investment vehicle, the renminbi's performance has been comparatively less impressive with investors showing a marked decline in RMB. In the following sections, each of these aspects of renminbi internationalisation—payments, funding, and investment—will be discussed in detail.

3.1 Yuan Share of Global Payment and Trade Finance

The share of the Yuan in global payment and finance has seen a marked increase since 2023 according to the data provided by SWIFT. As shown in Figure 1, the Yuan share in global payments jumped to 4.7 percent in March 2024 from 2.26 percent in March 2023. In the process, it has left behind the Japanese yen. However, despite this increase, as illustrated in Figure 2, the Yuan fraction remains far behind that of the U.S. dollar which holds a 47 percent share in the global payment and also the Euro, holding a 23 percent share.⁵

⁴ Hyoung-kyu Chey, *The International Political Economy of the Renminbi: Currency Internationalisation and Reactive Currency Statecraft*, 1st edition (New York: Routledge, 2023).

⁵ Swift, *RMB Tracker: Monthly Reporting and Statistics on Renminbi (RMB) Progress Towards Becoming an International Currency*, April 2024, 1–8. Accessed November 17, 2024. <https://www.swift.com/products/renminbi/details>.

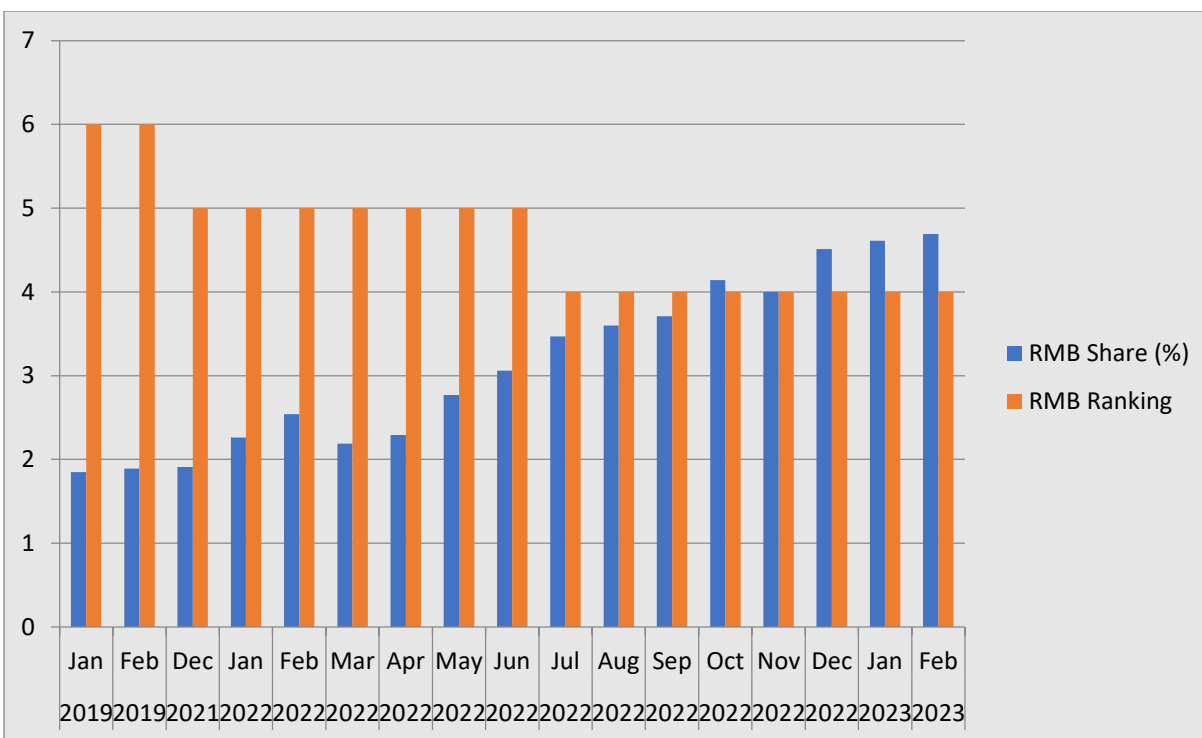


Figure 1: Yuan's Share as a Global Payment Currency⁶
Source: Swift, RMB Tacker

Turning to the Yuan's share as a global currency in the trade finance market, we have observed a similar trend. As per data from SWIFT, the share of the Yuan in global trade financing has increased to 5.28 percent in 2024 from around 4.5 percent in 2023 which puts the Yuan at about the same level as the Euro. Having said this, it is worth noting that with a whopping share of 84 percent, the U.S. dollar continues to dominate world trade financing.⁷

⁶ Swift, *RMB Tracker*, 6.

⁷ Swift, *RMB Tracker*, 7.

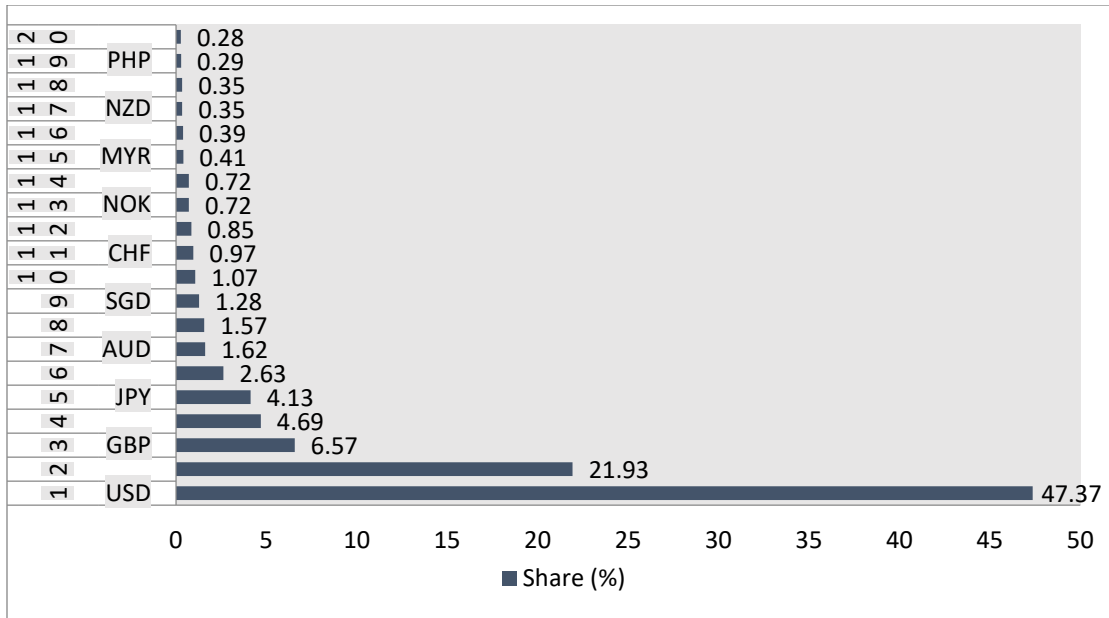


Figure 2: Yuan's Share as a Global Payment Currency vis a vis other Currencies⁸
Source: Swift, RMB Tacker

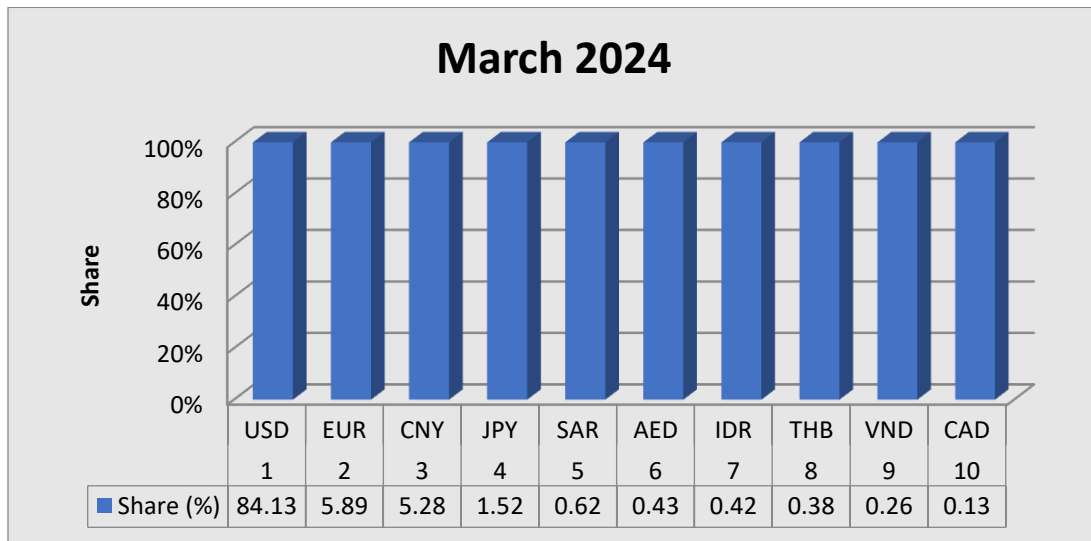


Figure 3: Yuan's Share as Global Currency in Trade Financial Market⁹
Source: Swift, RMB Tacker

⁸ Swift, RMB Tracker.

⁹ Swift, RMB Tracker, 7.

4. FACTORS BEHIND YUAN'S GROWING SHARE IN GLOBAL PAYMENTS AND TRADE FINANCE

The increase in the Yuan's share in global payments and trade finance can be attributed to several factors. The foremost reason is the growing use of the Yuan by several countries that are engaged in trade with China. According to the data provided by SWIFT, currently, more than 100 countries are using the Yuan for payments and trade with China and Hong Kong.¹⁰ It would be a difficult endeavour to provide details of more than 100 countries in a single working paper; however, to provide an overview, we will focus on some of the leading countries for a general trend analysis .

Russia is one of the leading countries using the Chinese Yuan for trade and financial transactions, particularly since the onset of the Russia-Ukraine war when the Western countries led by the United States imposed sanctions on Russia. This resulted in the freezing of about half of Russia's \$640 billion in foreign currency reserves. The sanctions forced Moscow to seek alternatives to the U.S. dollar and euro for international transactions, consequently, the Chinese Yuan quickly emerged as a viable option. As per the data of Russia's central bank, by March 2023, Russia had bought 41.9 billion rubles (approximately \$538 million) worth of Yuan. This reflects the growing use of Chinese Yuan for Russia's international transactions. Moreover, in Russia's foreign exchange market, Yuan-ruble trades have outpaced ruble-dollar exchanges with

¹⁰ "More than 100 Countries Are Now Using the RMB for Payments with China and Hong Kong," Swift, October 27, 2016, <https://www.swift.com/news-events/press-releases/more-100-countries-are-now-using-rmb-payments-china-and-hong-kong>.

Yuan trading accounting for 54% of the total trade volume, surpassing the dollar's 34% share.¹¹

Much like Russia, Iran has also increasingly turned to the Chinese Yuan for trade and financial transactions owing to stringent Western sanctions. In recent years, China has become a critical trading partner for Iran, with the former purchasing around 90% of Iran's exported oil in 2023. Iran receives payment for this oil in Yuan enabling it to bypass dollar-based financial restrictions. The Yuan payments are then used by Iran to pay for imports from China; a key supplier of goods to Iran. For instance, in 2022, Iran imported \$2.12 billion worth of machinery and \$1.43 billion worth of electronics from China.¹² Although detailed data on financial transactions between Iran and China is lacking, it is widely argued that much of Iran's Chinese technology purchases and other imports are settled in Yuan.

China has established similar currency arrangements with other major trade partners as well, such as Saudi Arabia and Brazil. Consider the case of Saudi Arabia first. In November 2023, Beijing and Riyadh signed a three-year currency swap agreement worth \$6.93 billion, which allowed trade between the two countries to be conducted in Yuan. As one of China's largest oil suppliers, Saudi Arabia now sells oil to China and receives payments in Yuan. The Yuan is then used by Saudi Arabia to

¹¹ "Russia's Central Bank Steps Up Yuan Sales Amid Deficit," The Moscow Times, October 7, 2024, <https://www.themoscowtimes.com/2024/10/07/russias-cbr-steps-up-yuan-sales-amid-deficit-a86602>.

¹² Kimberly Donovan and Maia Nikoladze, "The Axis of Evasion: Behind China's Oil Trade with Iran and Russia," *Atlantic Council*, March 28, 2024, <https://www.atlanticcouncil.org/blogs/new-atlanticist/the-axis-of-evasion-behind-chinas-oil-trade-with-iran-and-russia/>.

purchase Chinese goods or invest within China, creating a mutually beneficial "barter trade" dynamic.¹³

Brazil has the same story. In March 2023, Brazilian bank Banco BOCOM BBM reached an agreement with China that would thereon facilitate transactions directly in Yuan and Brazilian real.¹⁴ Moreover, the Brazilian Central Bank has increased the share of the Yuan in the country's foreign reserves by 5.37 percent surpassing the euro's 4.78 percent share to become the second most dominant currency in Brazil's foreign reserves.¹⁵

Argentina is another country that is increasingly using the Yuan for international trade and other transactions. In April 2023, Argentina's Economy Minister, Sergio Massa, announced that Argentina would start using the Yuan to pay for imports from China. Initially, Argentina aimed to cover \$1 billion in imports using the Yuan. An important development in this regard was the activation of a currency swap line between China and Argentina which allowed Argentina to access \$1.04 billion worth of Yuan to cover imports.¹⁶

The swap line was later on expanded to \$18 billion over three years and helped Argentina's central bank to increase its Yuan availability from approximately \$5 billion to

¹³ Joe Cash, "China, Saudi Arabia Sign Currency Swap Agreement," *Reuters*, November 20, 2023, sec. Currencies, <https://www.reuters.com/markets/currencies/china-saudi-arabia-central-banks-sign-local-currency-swap-agreement-2023-11-20/>.

¹⁴ "Brazil Takes Steps to Transact in Yuan as China Ties Grow," *Bloomberg.Com*, March 30, 2023, <https://www.bloomberg.com/news/articles/2023-03-30/brazil-takes-steps-to-transact-in-yuan-as-ties-with-china-grow>.

¹⁵ "Yuan Tops Euro as Brazil's Second Currency in Foreign Reserves," *Reuters*, March 31, 2023, sec. Currencies, <https://www.reuters.com/article/markets/currencies/yuan-tops-euro-as-brazils-second-currency-in-foreign-reserves-idUSL1N3632DU/>.

¹⁶ Alexandra Sharp, "Argentina Turns to Yuan to Save Dwindling Dollars," *Foreign Policy*, November 26, 2024, <https://foreignpolicy.com/2023/04/27/argentina-yuan-china-dollar-currency-trade-imports-imf-diplomacy/>.

nearly \$10 billion. Moreover, Argentinian banks are now authorised to offer savings and checking accounts denominated in the Chinese currency. Last but not least, Argentina has also begun part of its \$2.7 billion debt repayment to the International Monetary Fund (IMF) in Yuan.¹⁷

This growing use of the Yuan by a rising number of countries around the world explains the Yuan's increasing share in global payments and trade finance. Regarding the growing share of Yuan in global trade finance, there is another factor worth looking at: the low Chinese interest rates.

Currently, the Chinese interest rates are lower than those in the advanced economies which make the Yuan an attractive financing currency.¹⁸ For instance, as of 2024, China's one-year loan prime rate (LPR) is around 3.65%, and the five-year LPR is about 4.3%.¹⁹ In contrast, the U.S. Federal Reserve has set its benchmark interest rate between 5.25% and 5.5%.²⁰ The higher the interest rate, the higher will be the cost of financing and vice versa. Thus, Chinese lower interest rates translate into significant cost savings for companies financing trade in Yuan and make the Yuan an appealing alternative for financing. Consequently, it contributes to the currency's increased share in global trade finance.

¹⁷ Eliana Raszewski, "Argentina Doubles China Currency Swap Access to \$10 Bln," *Reuters*, June 2, 2023, sec. Currencies, <https://www.reuters.com/markets/currencies/argentina-renew-expand-china-currency-swap-line-2023-06-02/>.

¹⁸ Bastian von Beschwitz, "Internationalization of the Chinese Renminbi: Progress and Outlook" (The Federal Reserve, August 30, 2024), <https://www.federalreserve.gov/econres/notes/feds-notes/internationalization-of-the-chinese-renminbi-progress-and-outlook-20240830.html>.

¹⁹ "China Loan Prime Rate," Trading Economics, accessed November 17, 2024, <https://tradingeconomics.com/china/interest-rate>.

²⁰ "Press Release: Federal Reserve Issues FOMC Statement," The Federal Reserve, August 30, 2024, <https://www.federalreserve.gov/newsevents/pressreleases/monetary20240612a.htm>.

While this lower interest rate of China partly explains the growing use of Yuan in global trade financing in recent years, it does not provide a full account, especially considering the fact that the U.S. dollar, despite higher interest rates, continues to dominate the global trade financing with an 84 percent share in global trade financing.²¹

5. YUAN'S SHARE IN GLOBAL FOREIGN EXCHANGE RESERVES

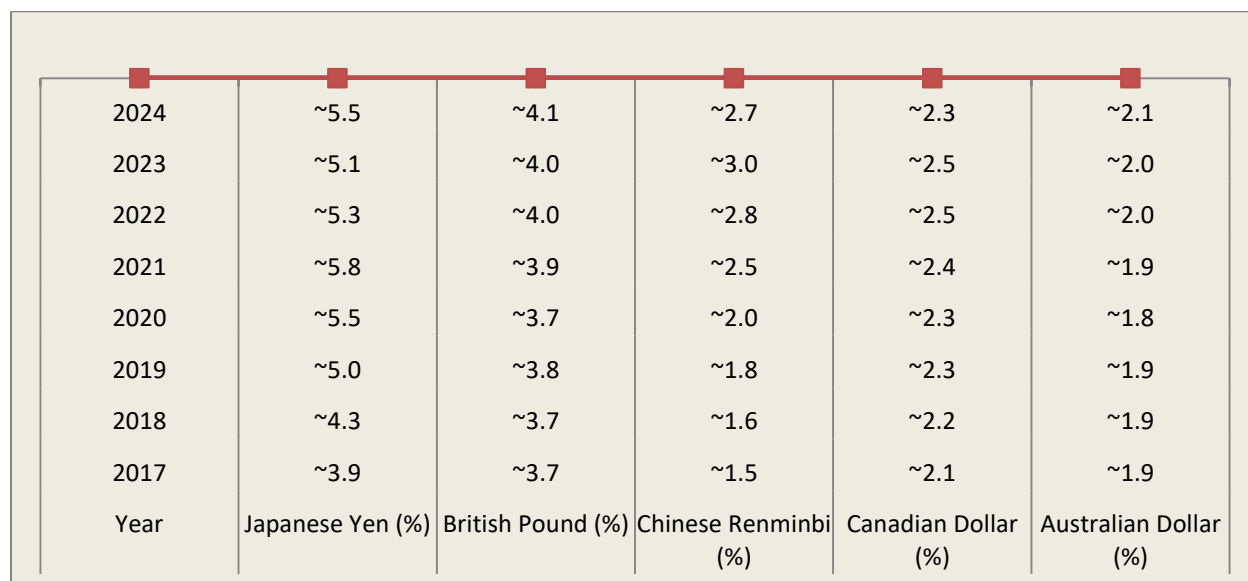
Focusing on the function of the medium of exchange an international currency performs in the previous section, we discussed at length the share of the Yuan in global payments and trade finance to assess its internationalisation. In this section, we will shift our focus to the function of a store of value.

As mentioned before in this paper, when an international currency is used as a reserve currency by countries worldwide, it serves the function of being a store of value. Thus, in the wake of this function, official reserve holdings worldwide in a particular currency serve as an important indicator of measuring the international usage of that specific currency.

When it comes to the function of the store of value, the Yuan's performance is not as impressive as a the function of a medium of exchange. The numbers bear testimony to this fact. Although the share of the Yuan in global reserves has increased since its inclusion in the IMF's Special Drawing Rights basket in 2016, its role remains relatively minor. For instance, in 2016, the Yuan constituted just 1.1% of the global official foreign

²¹ Swift, *RMB Tracker*, 6.

exchange (FX) reserves. The figure then grew to 2.8% in 2022. However, more recently, the Yuan's share has declined to around 2.3% and has since been stagnant at this level. Consequently, it puts the Yuan in a position comparable to niche reserve currencies like the Australian and Canadian dollars that hold a very small fraction of global reserve assets.²²



2024	~5.5	~4.1	~2.7	~2.3	~2.1
2023	~5.1	~4.0	~3.0	~2.5	~2.0
2022	~5.3	~4.0	~2.8	~2.5	~2.0
2021	~5.8	~3.9	~2.5	~2.4	~1.9
2020	~5.5	~3.7	~2.0	~2.3	~1.8
2019	~5.0	~3.8	~1.8	~2.3	~1.9
2018	~4.3	~3.7	~1.6	~2.2	~1.9
2017	~3.9	~3.7	~1.5	~2.1	~1.9
Year	Japanese Yen (%)	British Pound (%)	Chinese Renminbi (%)	Canadian Dollar (%)	Australian Dollar (%)

Figure 4: Trends in Global Foreign Exchange Reserves by Selected Currencies (2017–2024)²³
Source: IMF COFER 2024

²² “Currency Composition of Official Foreign Exchange Reserves (COFER),” International Monetary Fund (IMF), 2024, <https://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4>.

²³ Ibid.

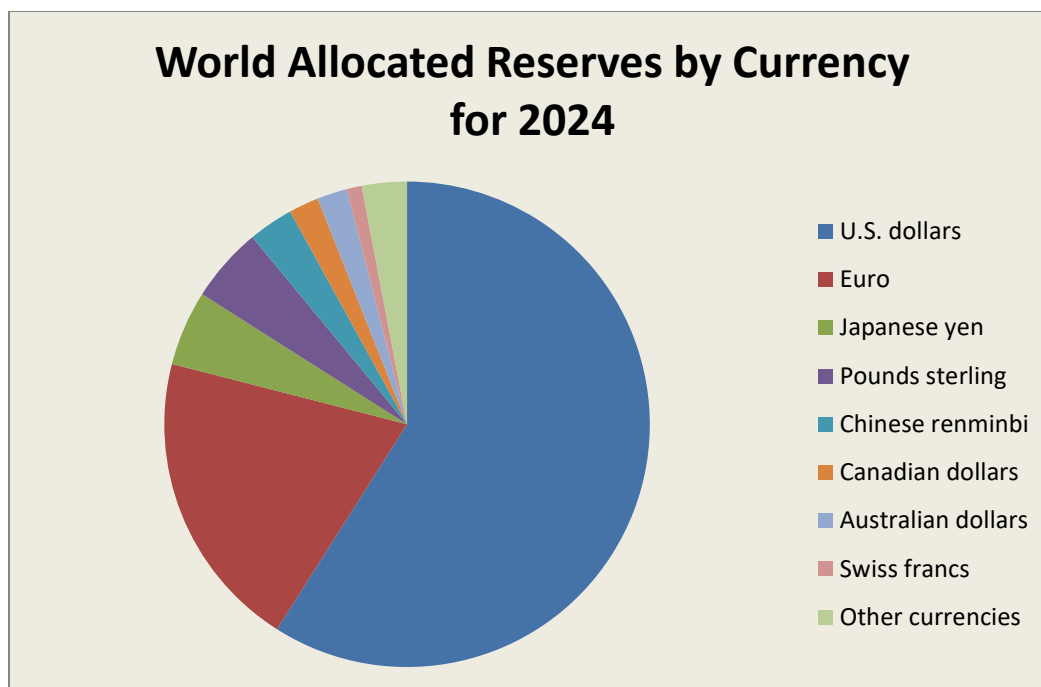


Figure 5: Share of Various Currencies in Global Reserves²⁴
Source: IMF COFER 2024

In contrast to the Yuan, the U.S. dollar with a substantial share of 58.2 percent in global reserves remains the dominant reserve currency followed by the euro, yen, and pound.²⁵ The Yuan's limited share reflects the challenges it faces in competing with these established international currencies. These challenges are important to understand and thus will be taken up in the next section, where we will examine the factors that hinder the path of Yuan's full internationalisation.

6. CHALLENGES TO YUAN'S INTERNATIONALISATION

There is a pressing question at the heart of the internationalisation of the Yuan: Why doesn't the currency of the second-largest economy in the world play a consequential

²⁴ "Currency Composition of Official Foreign Exchange Reserves (COFER)."
²⁵ Ibid.

and robust international role? Particularly as a reserve currency and after so many years? The answer is that there are ample challenges mainly related to the structure of the Chinese economy that are hampering the full internationalisation of the Yuan. These challenges include restrictive capital controls and limited financial market depth.

6.1 Capital Controls and Limited Convertibility of the Yuan

One of the key challenges to the internationalisation of the Yuan lies in China's capital controls and limited currency convertibility of the Yuan. Capital controls are a sort of restrictions imposed by the government that limit the flow of foreign capital in and out of a country.²⁶ It implies that China actively regulates how much foreign currency can enter or leave its economy and controls how the Yuan can be exchanged across borders.²⁷

Currency convertibility, on the other hand, refers to how easily a country's currency can be exchanged for other currencies. A fully convertible currency, like the U.S. dollar, can be freely traded on global markets without restrictions making it easy for international businesses and governments to hold and use dollars. However, that is not the case with the Chinese Yuan. China has put limits on the Yuan's convertibility meaning that foreign entities often face restrictions on buying or selling Yuan freely. Foreign companies and investors must go through long approval processes to access

²⁶ Bryan Mercurio, Ross Buckley, and Erin Jiangyuan Fu, "THE LEGITIMACY OF CAPITAL CONTROLS DURING A RETREAT FROM GLOBALISATION," *International & Comparative Law Quarterly* 70, no. 1 (January 2021): 59–101, <https://doi.org/10.1017/S0020589320000433>.

²⁷ Yongding Yu, *Revisiting the Internationalization of the Yuan*, ADBI Working Paper No. 366 (Tokyo: Asian Development Bank Institute, July 2012), 1–26. Accessed November 01, 2024. <http://www.adbi.org/working-paper/2012/07/04/5137.revisiting.internationalization.yuan/>.

China's onshore Yuan market, which limits the ease with which large amounts of foreign currency can be converted into Yuan or transferred out of China.²⁸

These limitations, according to many scholars, reduce the Yuan's attractiveness as a global currency and usually deter foreign entities from holding large reserves in the Yuan. They argue that the Yuan cannot develop as an international reserve currency without the full liberalisation of China's capital account based on this simple logic that countries will not hold Yuan reserves if they cannot easily purchase and sell them in international markets.²⁹

6.2 Limited Financial Market Depth

Another significant challenge to the complete internationalisation of the Yuan is the limited depth of China's financial markets.³⁰ Market depth, in the lexicon of the economy, refers to the variety and volume of financial assets, such as bonds and equities, which are available for investors to buy and sell without major price fluctuations. A market is considered deep when it offers an extensive variety of assets. Consequently, it attracts global investors who seek liquidity and stability for their investments.

In comparison to the financial markets of Europe and those of the United States, Chinese financial markets are considered shallow. Just to provide an example, in the

²⁸ Yongding Yu, *Revisiting the Internationalization of the Yuan*

²⁹ Barry Eichengreen et al., *Is Capital Account Convertibility Required for the Renminbi to Acquire Reserve Currency Status?* Banque de France Working Paper No. 892, November 2022, 1–40. Accessed November 17, 2024. <https://publications.banque-france.fr/sites/default/files/medias/documents/wp892.pdf>.

³⁰ Barry Eichengreen and Masahiro Kawai, *Issues for Renminbi Internationalization: An Overview*, ADBI Working Paper No. 454 (Tokyo: Asian Development Bank Institute, January 2014), 1–20. Accessed November 17, 2024. <http://www.adbi.org/working-paper/2014/01/20/6112.issues.renminbi.internationalization.overview/>.

United States, the bond market alone stands at roughly \$51.3 trillion. By comparison, China's bond market is only \$20.9 trillion.³¹

Moreover, it is also one of the underutilised markets by international investors. For instance, less than 3 percent of Chinese bonds are owned by international investors.³² This lower participation by international investors implies that the Yuan lacks appeal as a reserve currency.

China's Bond Market		
2021	~520	~3.1%
2020	~400	~2.5%
2019	~300	~2.0%
2018	~250	~1.8%
2017	~150	~1.0%
2016	~100	~0.5%
Year	China's Bonds Held by Foreign Investors (USD billions)	China's Bonds Foreign Ownership (%)

Figure 6: Share of Foreign Investment in China's Bond Market³³

Source: Allianz Global Investors

For China to boost the Yuan's role as a global reserve currency it would not only need to grow its financial markets but would also need to diversify the types of assets

³¹ Derothy Neufeld, "The Largest Bond Markets in the World," World Economic Forum, April 17, 2023, <https://www.weforum.org/stories/2023/04/ranked-the-largest-bond-markets-in-the-world/>.

³² Allianz Global Investors, *9 Things to Know About China's Bond Markets*. March 2021. <https://www.allianzgi.com/-/media/allianzgi/globalagi/china-microsite/9-things-to-know/9-things-to-know-about-chinas-bond-markets.pdf?rev=fed31332729341e1b66a9b43932a6a38&hash=9E3AD5EAE3C2275D934C1ABBE170D20C>

³³ Ibid.

available to the investors. This includes expanding corporate bonds, government securities, and other financial products to appeal to a broader international audience much like the range and diversity found in Western markets.

7. FUTURE OUTLOOK OF YUAN INTERNATIONALISATION

Predicting the future of a phenomenon in the social sciences is a challenging endeavor, especially considering that several variables interact in complex ways to determine and shape that particular phenomenon. The same is true about the future of the Yuan internationalisation. Though we cannot predict the future of Yuan internationalisation precisely, we can certainly make an educated guess.

As evident from the discussion above, the Yuan is gradually but surely advancing towards becoming an international currency. We have observed this trend for the past few years in which the Yuan's global role has increased notably from a very low starting point. However, despite this growth, the Yuan's international usage still lags behind even that of the British pound and Japanese yen, let alone the U.S. dollar and the euro. This is particularly striking given the fact that the Chinese economy is, broadly speaking, of comparable size to those of the U.S. and the European region.

This is due to the fact that the Yuan faces key challenges on its path to becoming a fully international currency. As discussed previously in the paper, China's restrictive capital controls, limited currency convertibility, and relatively shallow financial market are deterring investors and central banks from holding Yuan reserves which is an important step in the full internationalisation of a currency. The trend will likely continue in the future as well if China does not liberalise its capital account or if its financial market

depth remains constrained. Consequently, the Yuan will likely continue to face an uphill task in attracting widespread adoption in comparison to that of the U.S. Dollar and Euro.

Thus, going forward, it can be argued that further increases in the international role of the renminbi seem likely, especially in the function of a medium of exchange. However, in any case, barring any large-scale radical political or economic shifts that undermine the trust in the U.S. dollar; the Chinese Yuan will not likely rival the U.S. dollar for the role of the dominant global currency in the foreseeable future.

8. IMPLICATIONS FOR PAKISTAN'S ECONOMY

The implications of the internationalisation of Yuan on Pakistan's economy can only be analysed by going through the underlying macroeconomic indicators individually, that show the condition of Pakistan's economy in particular and the economy of any state in general. These indicators are key metrics that help assess the overall economic health, stability, and potential vulnerabilities of a country. When analysing the potential impact of the Yuan's internationalisation on Pakistan's economy, examining these macroeconomic indicators provides a comprehensive view of how shifts in currency dynamics might influence various aspects of Pakistan's financial and economic landscape.

8.1 Pakistan's Trade Statistics

Based on the data provided by Pakistan's Bureau of Statistics, Pakistan's trade statistics in FY23 are as follows:

8.1.1 Country-Wise Export Data (FY23)

The United States remained Pakistan's largest export destination, despite a decrease in its share from 21.23% in FY22 to 18.67% in FY23.³⁴ This was followed by exports to China, the United Kingdom, the Netherlands, Germany, and Spain. Together, these six countries constituted 50% of Pakistan's total exports for FY23, a slight decline from 53.3% in FY22.³⁵

Growth in Specific Markets: While exports to the United States dropped, Pakistan saw increases in exports to Germany, the UAE, Spain, and Italy, suggesting a diversification in export destinations within Europe and the Middle East.³⁶

8.1.2 Country-Wise Import Data (FY23)

China was Pakistan's leading import source, contributing 21.58% of the total imports. The top import sources were the United Arab Emirates (10.42%), Saudi Arabia (7.79%), Indonesia (7.79%), Qatar (6.49%), and Kuwait (4%).³⁷ These six countries contributed the majority of Pakistan's imports in FY23. The United States followed these countries with 3.97% of total imports.³⁸

Collective Share of Key Partners: Combined, the top ten countries accounted for 67% of Pakistan's total imports, emphasising a strong reliance on a few key trade partners, particularly in Asia and the Middle East.³⁹

³⁴ Dr Naeem Zafar, "Pakistan Bureau of Statistics, External Trade Section I. Report on External Trade," March 2024, https://www.pbs.gov.pk/sites/default/files/external_trade/Annual_Analytical_Report_on_External_Trade_Statistics_of_Pakistan_FY2023.pdf.

³⁵ Ibid.

³⁶ Ibid

³⁷ Ibid

³⁸ Ibid

³⁹ Ibid

8.1.3 Implication of Yuan's internationalisation on Pakistan's Trade

Pakistan has seen a significant rise in trade conducted in Chinese Yuan (CNY) in recent years. In 2023, around 14% of its trade with China was settled in Yuan, a substantial increase from just 2% in 2018.⁴⁰ Trade agreements particularly with China and Russia, are gradually increasing transactions in Chinese renminbi instead of U.S. dollars, reducing Pakistan's reliance on dollar reserves. Since Pakistan's imports from China remain the highest, trading in Yuan will reduce the need for U.S. dollars. This shift has already been facilitated by a structured framework set up by the State Bank of Pakistan (SBP), which has designated banks like ICBC (Industrial and Commercial Bank of China), BOC (Bank of China) and SCB (Standard Chartered Bank) to handle transactions in Yuan.⁴¹ This move aims to ease pressure on Pakistan's foreign exchange reserves, traditionally reliant on the US dollar, and to support trade with China, as well as with other nations like Russia, where payments for fuel are also increasingly made in Yuan. The growing use of the Yuan for bilateral trade is part of Pakistan's broader strategy to diversify its currency exposure, reduce dependency on the dollar, and improve trade efficiency with key partners.

Using Yuan for trade with China specifically will lower transaction costs by removing the need for repeated currency conversions. Smaller companies that might lack the means to adequately handle high foreign exchange expenses will particularly benefit from this. Typically, Pakistan has to pay extra conversion rates while dealing in U.S.

⁴⁰ Iftikhar Opel, "Trade in Yuan Reaches 14% FPCCI to Work to Diversify & Enhance Exports to China Atif Ikram Sheikh – FPCCI," The Federation of Pakistan, April 2024, <https://fpcci.org.pk/trade-in-yuan-reaches14-fpcci-to-work-to-diversify-enhance-exports-to-china-atif-ikram-sheikh/>.

⁴¹ "Use of RMB to Facilitate Trade with China" (State Bank of Pakistan, September 27, 2023), <https://www.sbp.org.pk/press/2023/Pr-27-Oct-2023.pdf>.

currencies.⁴² For instance, in order to purchase machinery from China, a Pakistani importer usually needs to exchange Pakistani rupees (PKR) for U.S. dollars (USD), which are then exchanged for Chinese Yuan (CNY).⁴³ The cost of the transaction is increased by fees associated with each conversion stage of this two-step procedure. Pakistan can avoid multiple conversion fees and lower overall transaction expenses by using the Yuan directly instead of the U.S. currency.⁴⁴

Moreover, cost savings and increased trade efficiency have been recorded by nations that switched to using their own currency. For example, ASEAN countries have made cross-border trade easier by implementing local currency settlement (LCS) systems, which have lowered banking costs and expedited invoicing procedures.⁴⁵ If the Yuan gains traction, Pakistan's commerce with China may reap comparable advantages.

However, with 18.67% of exports in FY23, the United States continues to be Pakistan's largest trading partner, despite a fall in its share of exports. Around 50% of Pakistan's overall exports come from its substantial trade with European nations including the UK, Germany, and the Netherlands. The internationalisation of the Yuan would probably have no immediate impact on the dollar-based commerce with the United States and Europe. Dollars would still be used for transactions in industries like

⁴² "Surging Pak-China Trade in Yuan to Stabilise Reserves, Support Rupee: PIAF," The Nation, January 29, 2024, <https://www.nation.com.pk/29-Jan-2024/surging-pak-china-trade-in-yuan-to-stabilise-reserves-support-rupee-piaf>.

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ Marsha Phoebe, "The Future of ASEAN Financial Integration through the Local Currency Settlement Framework," Modern Diplomacy, June 18, 2022, <https://moderndiplomacy.eu/2022/06/18/the-future-of-asean-financial-integration-through-the-local-currency-settlement-framework/>.

textiles, which are highly dependent on American demand;⁴⁶ a switch to the Yuan would not have a major short-term effect on these trading links.

8.2 Currency Exchange Rate

As of November 2024, the exchange rate for the Pakistani rupee (PKR) is approximately PKR 277.90 for 1 US Dollar (USD) and PKR 39.16 for 1 Chinese Yuan (CNY).⁴⁷ Although Yuan is valued less against the Pakistani Rupee compared to the Dollar, nevertheless, these rates are reflective of fluctuations in the interbank market and currency demand in trade and foreign exchange reserves globally.

8.2.2 Implications of Yuan's Internationalisation on Currency Exchange Rates

If the Yuan becomes more internationalised, its exchange rate against the Pakistani rupee could rise, depending on increased demand for the Yuan in trade. For example, in 2023, China accounted for 21.58% of Pakistan's total imports. A greater reliance on the Yuan for trade could lead to its appreciation relative to the Pakistani rupee. However, factors such as China's economic policies, the global demand for Yuan, and Pakistan's foreign exchange policies will ultimately influence the exchange rate. The Chinese government has segmented its currency markets:

Onshore Market (CNY): This market operates within mainland China, where the People's Bank of China (PBOC) sets a daily midpoint rate and allows the Yuan to trade

⁴⁶ "Pakistan Becomes Top Buyer of US Cotton," The Express Tribune, November 11, 2024, <https://tribune.com.pk/story/2508827/pakistan-becomes-largest-buyer-of-us-cotton>.

⁴⁷ "USD Exchange Rate Pakistani Rupee Falls Slightly against Greenback," The Express Tribune, November 6, 2024, <https://tribune.com.pk/story/2507806/USD-exchange-rate-pakistani-rupee-falls-slightly-against-greenback>.

within a restricted band ($\pm 2\%$) around this midpoint. The PBOC may intervene here to stabilise or control Yuan movements based on its economic and policy objectives.⁴⁸

Offshore Market (CNH): Located outside mainland China (e.g., in Hong Kong), the offshore Yuan operates with fewer restrictions. There's no central bank intervention or fixed trading band, so the CNH rate often reflects market-driven forces more closely than the CNY rate.⁴⁹

The segmentation of these markets can lead to minor differences in exchange rates, which may reflect unique investor responses in each market. As the onshore (CNY) and offshore (CNH) markets operate differently, with China controlling the CNY through daily midpoint rates, shifts in Yuan value may depend on China's monetary policies and demand for Yuan in global markets. If demand rises, the Yuan's appreciation could make imports from China more expensive, potentially affecting Pakistan's trade balance, import costs, and inflation.

Moreover, China's specific approach to currency and monetary policy may make the Yuan more volatile than the dollar. Because of the U.S. financial system's relative openness, transparency, and status as the world's main reserve currency, the dollar has a strong hold on international markets and is highly liquid and stable. Conversely, China's economy is less open and more tightly regulated by the government, especially when it comes to currency management.⁵⁰ As a result, the Yuan may fluctuate in value in response to specific economic forces or changes in policy.

⁴⁸ Chang Shu, "One Currency, Two Markets: The Renminbi's Growing Influence in Asia-Pacific," *Bank for International Settlements*, April 2014, file:///C:/Users/user/Downloads/Documents/work446.pdf.

⁴⁹ Ibid.

⁵⁰ Ibid.

Nevertheless, if China chooses to fully open the currency to international markets and markets adjust to the Yuan's actual market value without PBOC intervention, and, if Yuan gains international acceptance and usage, it may eventually become more stable, with deeper liquidity and less volatility. In an open system, the appreciation of the Yuan could introduce similar currency risk for Pakistan as seen with the dollar. However, diversification into the Yuan could still provide stability benefits for Pakistan, particularly if China continues to trade or extend loans in Yuan, mitigating the impact of volatility on direct trade.

8.3 Foreign Exchange Reserves

In mid-October 2024, Pakistan's foreign exchange reserves surpassed \$11 billion for the first time in over two and a half years.⁵¹ According to the State Bank of Pakistan (SBP), reserves grew by \$215 million in the week ending October 11, marking twelve consecutive weeks of growth.⁵² This recent increase has been driven largely by inflows from the International Monetary Fund's (IMF) \$ 7 billion loan programme and additional external sources.⁵³ Over the past three months, reserves have expanded by approximately \$2 billion, with a notable half of this growth occurring after the disbursement of the IMF's first tranche in late September.⁵⁴

Factors that influence Pakistan's Foreign Exchange Reserves include:

⁵¹ "Pakistan's Forex Reserves Surge Past \$11bn, Highest in 30 Months," Profit, October 18, 2024, <https://profit.pakistantoday.com.pk/2024/10/18/pakistans-forex-reserves-surge-past-11bn-highest-in-30-months/>.

⁵² Ibid.

⁵³ Ibid.

⁵⁴ Ibid.

External Financing: The IMF loan program and other external sources remain primary drivers of reserve increases.

SBP Dollar Purchases: The SBP has reportedly been purchasing dollars from the local currency market to support debt repayments and boost reserves.

Trade and Currency Preferences: Trade agreements and transactions in a specific currency also influence the foreign exchange reserves.

8.3.2 Implications of Yuan's Internationalisation on Foreign Exchange

Reserves

Since a significant portion of Pakistan's imports and investments are tied to China, holding Yuan could lower the currency exchange costs for these transactions and reduce the reliance on dollars for Chinese trade, potentially making Pakistan's reserves more resilient to dollar-specific volatility. However, this shift could also expose Pakistan's reserves to different economic risks, especially since the Yuan's value is partly managed by the People's Bank of China.⁵⁵ Any major shifts in Chinese policy could affect the Yuan's value, impacting the worth of Pakistan's reserves. As a result, while Yuan internationalisation could help Pakistan reduce dollar dependency and lower some currency-related transaction costs, it would also require careful management to balance potential volatility and reliance on Chinese currency policy decisions.

⁵⁵ Stanley White and Winni Zhou, "How Does China Manage the Yuan, and What Is Its Real Value?," Reuters, August 9, 2019, <https://www.reuters.com/article/world/how-does-china-manage-the-yuan-and-what-is-its-real-value-idUSKCN1UZ0JT/>.

8.4 Foreign Direct Investments

In the fiscal year 2024, Pakistan witnessed a 17% increase in foreign direct investment (FDI), largely attributed to business-friendly policies introduced by the Special Investment Facilitation Council (SIFC).⁵⁶ According to the State Bank of Pakistan, total FDI for the year reached \$1.9 billion. In June 2024 alone, FDI was \$169 million, compared to \$122 million in June 2023, reflecting a significant year-on-year growth.⁵⁷

The largest source of foreign investment for Pakistan remains China, with an investment of \$568 million during the last financial year.⁵⁸ Hong Kong ranked as the second-largest investor, contributing \$359 million in FDI.⁵⁹ Other key investors include the United Kingdom, the United States, and Singapore, all of which play an important role in Pakistan's foreign investment landscape. The United States invested \$137 million which remains a modest amount when compared to Chinese investment.⁶⁰

8.4.2 Implications of Yuan's Internationalisation in the Context of Pakistan's FDI

As of fiscal year 2024, China is already the largest source of FDI for Pakistan, contributing significantly to the economy, with an investment of \$568 million in the past financial year.⁶¹ If the Yuan becomes more internationally accepted, this could lead to

⁵⁶ "Pakistan's Path to Economic Recovery under SIFC in FY-2024," Daily Independent, March 7, 2024, <https://dailyindependent.com.pk/pakistans-path-to-economic-recovery-under-sifc-in-fy-2024>.

⁵⁷ Ibid.

⁵⁸ Pervaiz Akhtar, "Ministry Of Information And Broadcasting (Moib), Pakistan," Moib.gov.pk, 2021, <https://moib.gov.pk/News/63192>.

⁵⁹ Ibid.

⁶⁰ Ibid.

⁶¹ Ibid.

more investments in Yuan-denominated assets or projects, reducing transaction costs for Chinese investors and potentially increasing the volume of Chinese FDI in Pakistan.

However, for FDI from other countries like the U.S., the UK, or Singapore, the impact would likely be limited in the short term. These countries continue to primarily use the U.S. dollar for transactions and investment. Unless the internationalisation of the Yuan leads to a broader shift in global currency practices, the FDI from these countries would likely remain in dollars, with limited direct influence from the Yuan's rise.

8.5 Foreign Remittances

According to the State Bank of Pakistan (2023), remittance inflows to Pakistan primarily come from the Gulf region, the United States, and the United Kingdom.⁶² On a country-specific basis, Saudi Arabia is the largest source, providing approximately \$4.4 billion, which represents 24% of total remittances.⁶³ This is followed by the United Arab Emirates (UAE), contributing USD 3.1 billion (17%), and the United Kingdom with USD 2.7 billion (15%).⁶⁴ Additionally, the United States accounts for 12% of remittance inflows to Pakistan.⁶⁵

This distribution aligns with the size of the Pakistani diaspora in these regions, as six of the top ten countries hosting Pakistani workers in 2023 also appear among the leading remittance sources. This pattern underscores the critical link between destinations of labour migration and remittance inflows, which play a crucial role in

⁶² "Pakistan – Snapshot of Remittance Inflows to Pakistan between January 2019 and February 2024 | Displacement Tracking Matrix," International Organization for Migration, 2024, <https://dtm.iom.int/reports/pakistan-snapshot-remittance-inflows-pakistan-between-january-2019-and-february-2024>.

⁶³ Ibid.

⁶⁴ Ibid.

⁶⁵ Ibid.

supporting Pakistan's economy by enhancing foreign exchange reserves and providing essential income to households across the country.

8.5.2 Implications of Yuan's Internationalisation for Pakistan's Foreign Remittances

The internationalisation of the Yuan is unlikely to have a significant impact on Pakistan's foreign remittances in the short term, especially given the current sources and nature of remittance inflows. As of 2023, the majority of Pakistan's remittances come from the Gulf region, the United States, and the United Kingdom, with these countries primarily conducting transactions in U.S. dollars. Saudi Arabia, the UAE, and the UK remain the largest contributor. Additionally, the remittance market is closely tied to the exchange mechanisms and financial infrastructures already established for the U.S. dollar, which remains dominant in the regions where Pakistan's largest remittance inflows are sourced. For example, remittance channels between the Gulf countries and Pakistan are highly dollar-centric due to long-established banking and financial systems. While the internationalisation of the Yuan might affect trade and finance with China, particularly as bilateral trade grows, it will not likely disrupt the remittance flows from regions like the U.S., UK, or the Gulf, where the U.S. dollar continues to dominate.

8.6 International Debt and Borrowing

A high share of external debt in Pakistan's total debt makes the country sensitive to currency fluctuations, especially since around 38% of public debt is external as of June 2023.⁶⁶ This debt composition exposes Pakistan to exchange rate volatility; when the

⁶⁶ "January 2023 Debt Management Office Ministry of Finance Report" (Finance Division Pakistan, 2024), https://www.finance.gov.pk/publications/DPS_2023.pdf.

Pakistani rupee (PKR) depreciates against foreign currencies, the debt burden increases, raising repayment costs. The depreciation of the PKR against the U.S. dollar, in particular, has inflated the cost of debt servicing despite efforts to reduce the debt stock in dollar terms.⁶⁷

8.6.2 Influence of Yuan's Internationalisation for Pakistan's Debt Servicing

Costs

In the context of the dollar versus Yuan debate, the internationalisation of the Yuan could potentially reduce Pakistan's debt servicing costs, particularly if a larger portion of its external debt is denominated in Yuan instead of dollars. This could stabilise or lessen currency depreciation, making external debt repayments more manageable. However, the underlying condition for such an ideal situation will demand consistency in the exchange rate of Pakistani rupee and Chinese Yuan. If the exchange rate of the Yuan rises relative to the Pakistani rupee, Pakistan's debt servicing costs on Yuan-denominated debt could increase. This would mean that, for every unit of Yuan owed, Pakistan would need to spend more in rupees to service the debt. As a result, any benefits of moving away from dollar debt would be offset by the Yuan's appreciation.

Moreover, the majority of Pakistan's financial exchanges with foreign organisations, such as the World Bank and the International Monetary Fund (IMF), are in U.S. dollars. Global reserves and international financial markets are dominated by the U.S. dollar. Because of the dollar's dominance in international finance, a switch to the Yuan might not have an immediate impact on Pakistan's financial channels for dealing with Western financial institutions. Pakistan's major international financial transactions and debt

⁶⁷

Ibid.

repayments are still mostly in dollars, despite China's increasing influence through programs like the Belt and Road Initiative (BRI) and increased borrowing in Yuan. Therefore, Pakistan's interactions with Western financial institutions, which still conduct business in U.S. dollars and other stable currencies, would not be significantly impacted by the internationalisation of the Yuan.

9. FINDINGS

- In recent years, the Yuan's international use has grown especially in global payments and trade finance. In global payments, Yuan's share has increased from 2.26% in 2023 to 4.7% in March 2024. However, despite this growth, it is trailing significantly behind other notable international currencies such as the U.S. dollar and euro with 47% and 23% share in global payments respectively.
- As a reserve currency, the Yuan's share is meagre with only a 2.3% share in global reserves especially if we compare it with the share of the U.S. dollar which is hovering around 58.2%.
- Over 100 countries use the Yuan for trade and payments with China and Hong Kong. Some prominent countries in this regard are Russia, Iran, Saudi Arabia, Brazil, and Argentina which have adopted the Yuan to mitigate their dependence on the dollar and euro in the face of sanctions or other financial constraints.
- There are two fundamental challenges to Yuan's complete internationalisation. The first is China's restrictive capital controls and partial convertibility of the Yuan, and the second is China's relatively shallow financial markets. Collectively

these two factors make the Yuan less attractive to foreign investors and governments to adopt it.

- The internationalisation of the Yuan is expected to expand gradually, especially in the function of the medium of exchange. However, without significant reforms to capital account policies and financial market depth, the Yuan is unlikely to challenge the U.S. dollar's global dominance as an international currency in the near future.
- The internationalisation of the Yuan holds the potential to significantly benefit Pakistan's economy by reducing dependence on the US dollar for trade with China, thereby, firstly, alleviating pressure on Pakistan's foreign exchange reserves. Secondly, with China being the major exporter to Pakistan, the bilateral trade with China in Yuan will offer lower transactions costs as compared to dollars, which in turn can reduce the total costs involved.
- If China allows the Yuan to float freely in international markets, the currency's value would be more exposed to market forces, possibly resulting in higher volatility initially as markets adjust. But over time, as the Yuan's role stabilises globally, it could gain value if China's economy remains strong and its financial system transparent and accessible to foreign investors. This could result in Yuan appreciation, offsetting the benefits of a narrower exchange rate gap between the Yuan and the Pakistani rupee in their bilateral trade and debt servicing costs.
- With China already being the largest source of FDI in Pakistan, Yuan-denominated investments could streamline capital flows from China, potentially

encouraging further investment growth. However, FDI from other countries, such as the U.S., the UK, and Singapore, would likely remain dollar-dominated, meaning the Yuan's internationalisation may have a limited impact on investments from these sources in the short term.

- Internationalisation of the Yuan would likely have minimal impact on Pakistan's foreign remittance flows in the short term, as remittances predominantly come from the Gulf, the U.S., and the UK, where the U.S. dollar remains central to financial transactions. Long-established banking channels in these regions are highly dollar-centric, making a currency shift to the Yuan unlikely to disrupt current remittance inflows to Pakistan.

10. CONCLUSION

The internationalisation of the Yuan represents a significant step in China's ambition to enhance its role in the global financial system. Over the years, the Yuan has steadily increased its presence in global payments and trade finance, reflecting its growing acceptance as a medium of exchange. This progress has been facilitated by strategic initiatives, such as currency swap agreements and the growing use of the Yuan by key trade partners, particularly in countries facing economic sanctions or seeking to diversify away from the U.S. dollar.

However, the journey of the Yuan's internationalisation is far from complete. While its role in global payments has gained traction, its adoption as a reserve currency remains limited, hindered by restrictive capital controls, limited currency convertibility, and the relatively shallow depth of China's financial markets. These structural challenges have

constrained the Yuan's ability to compete with established international currencies such as the U.S. dollar and the euro, which dominate global reserves and trade finance.

Looking ahead, the Yuan's role on the global stage is expected to grow, albeit gradually. While it may not challenge the dominance of the U.S. dollar in the foreseeable future, its increasing adoption as a medium of exchange suggests a potential for further integration into the global financial architecture.

The internationalisation of the Yuan presents a mixed bag of opportunities and challenges for Pakistan's economy. While the adoption of the Yuan in trade, foreign investments, and debt servicing could diversify currency exposure, reduce reliance on the U.S. dollar, and potentially lower transaction costs; the transition requires careful consideration of associated risks and broader global financial dynamics.

In essence, the Yuan's internationalisation could act as a supplementary pillar for Pakistan's economic framework, particularly in its trade and investment dealings with China. However, a balanced and strategic approach is essential to mitigate potential risks and ensure that the Yuan's growing role complements, rather than destabilises, Pakistan's broader economic objectives. As Pakistan navigates this transition, it must carefully manage its currency exposure, foster economic resilience, and remain adaptable to shifts in global financial systems.

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