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The "Weaponisation" of Money: Risks of Global Financial Fragmentation

by Jennifer Johnson-Calari, Arnab Das and Franco Passacantando

ABSTRACT

In response to the Russian invasion of Ukraine, Western countries decided to freeze Russia's foreign currency reserves and are now considering whether to use these reserves for supporting Ukraine. Markets and states have reacted to these measures in several ways. Central bank purchases of gold have reached levels not seen in the past 25 years. There has also been an acceleration in the use of the renminbi instead of western currencies as payment medium in trade. In the future Fintech developments could reduce the transparency of the global payment network and development of Central Bank Digital Currencies' platforms could offer a local currency alternative to a dollar-based payments system. The measures taken today on sovereign immunity of central bank reserves could set an important precedent that will have implications for a future multipolar world.

Russia | *Sanctions* | *Finance* | *Central banks* | *Currencies* | *China*

keywords

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The “Weaponisation” of Money: Risks of Global Financial Fragmentation

by Jennifer Johnson-Calari, Arnab Das and Franco Passacantando*

Introduction

In response to the Russian invasion of Ukraine, the main reserve currency-issuing countries decided to freeze the Central Bank of Russia’s foreign currency reserves held mostly in financial institutions in Europe and Japan. These countries also excluded Russian banks and individuals from using the payment messaging services of the Society for Worldwide Interbank Financial Telecommunication (SWIFT). The same countries, united under the G7, are now considering whether and how to use the frozen Russian reserves to support Ukraine.

These measures represent a major change with respect to previous sanction regimes, which never called into question the principle of central banks’ immunity, according to which central banks are protected from legal challenge from other states or foreign nationals. These unprecedented measures are a response to the unjustified aggression by Russia against a sovereign state, which was overwhelmingly condemned by the UN General Assembly as a violation of international law.[1]

While some commentators argue that the seizing of the Russian assets would be a legitimate measure to enforce international law and act as a deterrent for future aggressions, this legal point remains controversial. As recently advised by the Governor of the Bank of Italy,

> The issuer of a global currency can use its financial power to influence international developments. This power must be used wisely, however,

[1] UN News, *General Assembly Overwhelmingly Adopts Resolution Demanding Russian Federation Immediately End Illegal Use of Force in Ukraine, Withdraw All Troops*, 2 March 2022, https://press.un.org/en/2022/ga12407.doc.htm. The resolution was adopted with a vote of 141 in favour and five against (Belarus, Democratic People’s Republic of Korea, Eritrea, Russian Federation and Syria) and 35 abstentions.

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> because international relations are part of a ‘repeated game’: Weaponizing a currency inevitably reduces its attractiveness and encourages the emergence of alternatives.[2]

Is there indeed a risk that the weaponisation of money would lead to the fragmentation of financial markets? What we mean by fragmentation is not the loss of the dominant position of the dollar and the rise of other reserve currencies, which could be considered a natural, perhaps even welcome, consequence of a redistribution of global economic power from the “North” to the “South”. The risk of fragmentation is the risk of segmentation of the economic order into different, opposed camps, which could lead to trade restrictions and inefficiencies. In the immediate future, there is also a clear risk that certain countries will develop financial infrastructures outside of the reach of sanctions.

To gauge the severity of this risk, we will assess the potential impact on distinct components of the international financial system: international reserves, international payments and the market infrastructure at its core.

1. The principle of central banks’ immunity

To better understand what is at stake, it is useful to recall the economic rationale for the principle of central bank immunity. The justification of this principle is that in today’s fiat-currency world, the whole monetary system rests on the capacity to convert national currencies into the dollar and a few other reserve currencies, backed by trustworthy and credible states. Only if central banks’ reserve assets are considered “untouchable” can they play a role as a settlement medium, similar to the one that gold and other assets with an intrinsic value held in the past. To play this role, the International Monetary Fund (IMF) recognises as reserves only monetary gold and financial claims on non-residents. Furthermore, reserve assets are in practice custodied in extraterritorial jurisdictions – either with foreign central banks or with the main international custodians in the US and Europe.

Central bank reserves are a linchpin of the international monetary system necessary for mitigating shocks, smoothing global imbalances and reducing systemic risks. Reserves are a key tool to dampen exchange rate volatility, especially during episodes of financial stress. If this cannot be done, because reserves are unavailable (e.g. frozen), capital controls may need to be restored, resulting in fragmentation. Foreign exchange reserves are also important to preserve financial

[2] Fabio Panetta, *Beyond Money: The Euro’S Role in Europe’s Strategic Future*, Address at the Conference Ten ears with the euro, Riga, 26 January 2024, https://www.bancaditalia.it/media/notizia/fabio-panetta-speaks-at-the-international-conference-ten-years-with-the-euro-in-riga. For a review of the main issues currently being discussed see Agatha Demarais, “The Unintended Consequences of Seizing Russian Assets”, in *Foreign Policy*, 27 November 2023, https://foreignpolicy.com/?p=1130592.

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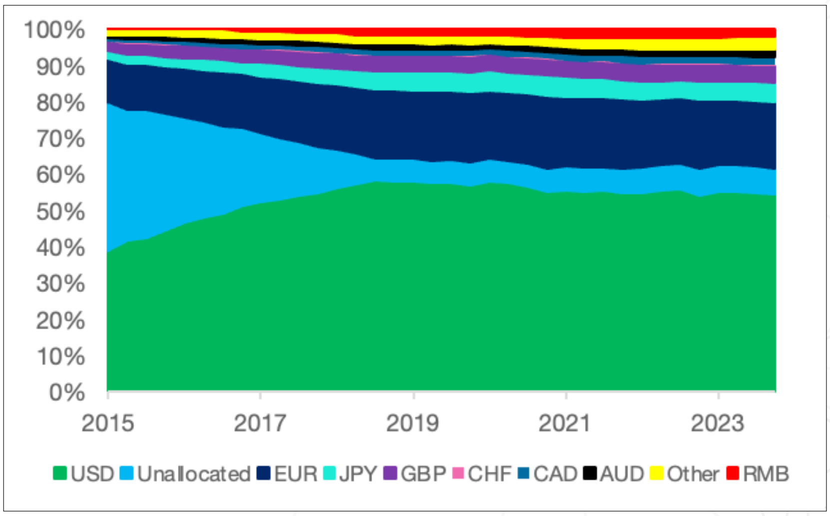
stability. It is well known that the 1997 Asian Financial Crisis led central banks of many developing countries to accumulate large pools of reserves to lessen this risk. According to the IMF, official reserves increased from 1.8 trillion US dollars at year-end 1999 to a 12.7 trillion at year-end 2021. And, in the ensuing years, they were a critical tool to mitigating the financial stress caused by the Covid lock downs.

Finally, central bank immunity is integral to their independence from governments and helps shield them from political interference. If central banks’ assets were vulnerable to litigation in court, some stakeholders could leverage this to influence the decisions of central banks in a way inconsistent with the best interest of the economy.

2. The continuous dominance of the US dollar as a reserve currency

According to the IMF, the US dollar continues to be the dominant reserve currency. Its current share of global reserves is around 60 per cent, against a level of 70 per cent in 2000, but in recent years its gradual decline has stabilised. The euro’s share of reserves continues to be below the Eurozone’s share of the global economy. Despite the inclusion of China’s renminbi in the IMF’s Special Drawing Rights (SDR) in 2016, at a weight of 10.9 per cent, Russia’s reserve shift from US dollar to renminbi and the recent increase in the use of renminbi for cross-border payments, the renminbi share of global reserves still stands at less than three per cent, half of which held by the Central Bank of Russia. The share of other currencies, like the Australian and Canadian dollars, the Swiss franc and the Korean won, however, are increasing.

Figure 1 | The US dollar dominates global foreign currency reserves due to the depth and liquidity of its capital markets



Note: Unallocated refers to reserves reported to the IMF without a currency specification.
Sources: IMF, Macrobond, Invesco. Quarterly data through 3Q-2024.

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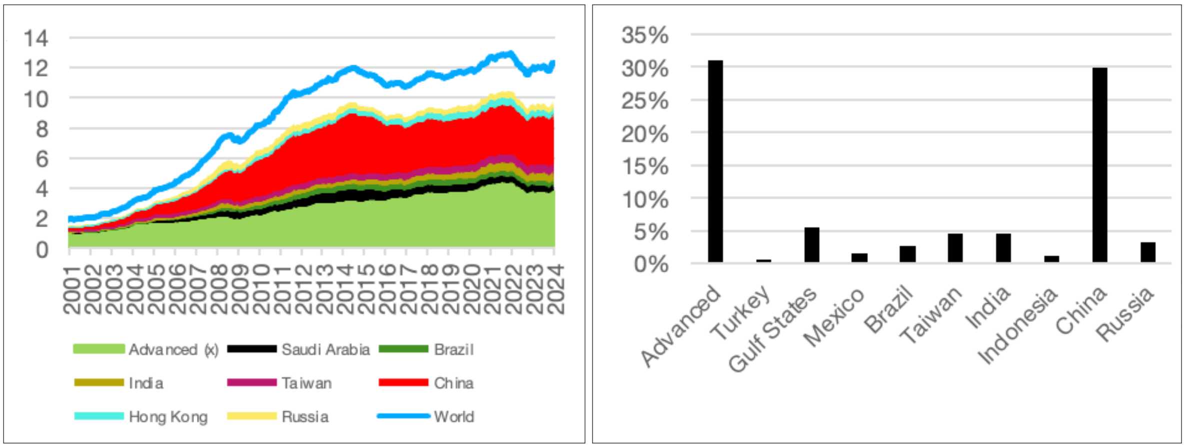
The main reason for the dollar dominance is the depth, breadth and liquidity of its capital markets, and the protection that domestic law and the courts have always provided to foreign central bank assets.[3] Furthermore, inertia and ‘network effects’ relating to the internationalisation of the dollar for invoicing and payments makes it difficult to challenge it. There are also geopolitical reasons. As Colin Weiss, an economist at the Board of Governors of the Federal Reserve, has shown, the majority (50-60 per cent) of safe US assets are held by countries with strong geopolitical relations with the United States and another 15 to 20 per cent by countries that receive some form of military support from the United States even without a formal alliance.[4]

Figure 2 | Share of US dollar reserves holdings: Allies, adversaries and friends



Note: Advanced – high-income countries excluding Taiwan. Gulf States excludes Iran.
Sources: IMF, Macrobond, Invesco. Left: data to Q1-2024. Right: Q4-2023 or latest available (Turkey, Q3-2023, Saudi Arabia, Q4-2023).

Among the non-aligned countries, China is of course the main holder of foreign currency reserves. China has reduced its holdings of US Treasuries by 262 billion US dollar, or 33 per cent, since the imposition of sanctions on Russia in early 2022. The most common view, however, is that China can only gradually de-dollarise because of its remaining exposure to US dollar denominated assets of about 1.8 trillion. In addition, China would have to hold vast dollar reserves if it wishes to continue to manage its exchange rate. As pointed out by Barry Eichengreen, the two reserve currencies, renminbi and US dollar, can be considered as complements, not substitutes.[5]

[3] For a comparative analysis of the quality and size of the capital markets of the main global currencies relative to the size of reserves, see Arnab Das and Jennifer Johnson-Calari, “De-dollarization Dilemmas”, in *Invesco Whitepapers*, October 2023, https://www.invesco.com/igsams/en/whitepapers.html.

[4] Colin Weiss, “Geopolitics and the U.S. Dollar’s Future as a Reserve Currency”, in *International Finance Discussion Papers*, No. 1359 (October 2022), https://doi.org/10.17016/IFDP.2022.1359.

[5] Barry Eichengreen et al., “Is Capital Account Convertibility Required for the Renminbi to Acquire Reserve Currency Status?”, in *Banque de France Working Papers*, No. 892 (November 2022), https://

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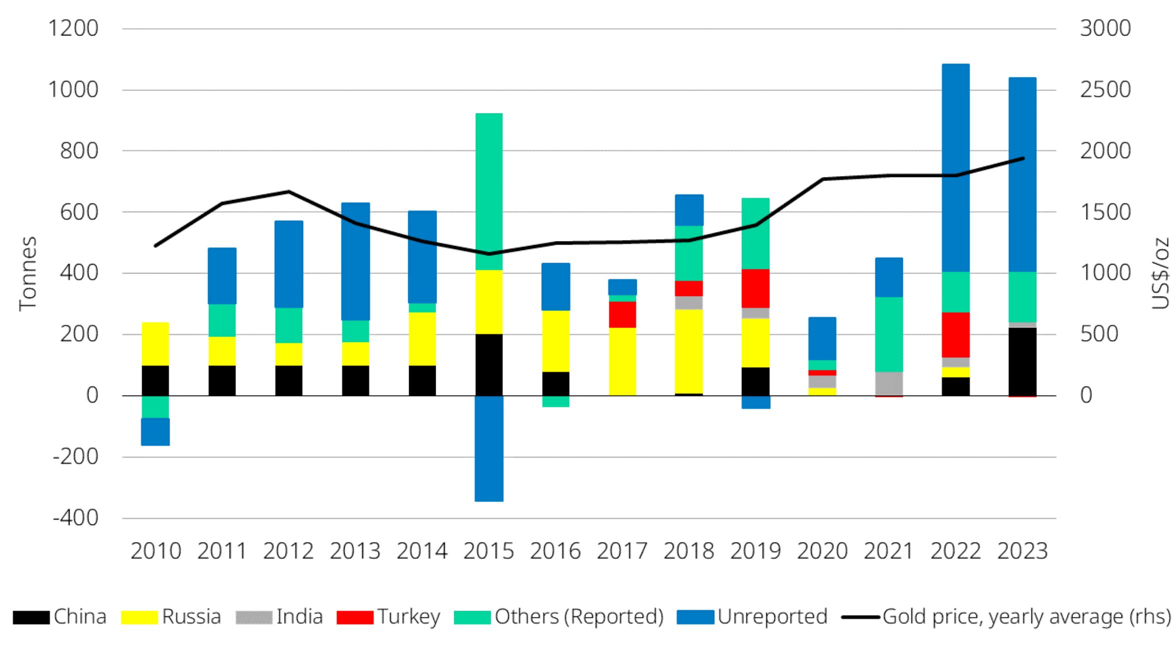
3. Gold and “tokens” as international reserves

Gold, as an international reserve asset, is the clear winner in the current circumstances. The allure of gold is that it is nobody’s liability, has inherent value and, if stored domestically, is out of the reach of foreign governments.

Following the 2007-08 great financial crisis, central banks from non-reserve-issuing currency countries began to accumulate gold. These purchases were dominated by India, Turkey, Russia and China and a relatively small number of other central banks, mainly in Central Asia and the Middle East. Since 2022, however, the size of reported central bank net purchases has reached levels not seen in the past twenty-five years and the breadth of central bank buying has also increased sharply in terms of both the number of buyers and their regional dispersion. Figure 3 illustrates the step changes in the size of central bank net purchases over the last two years.

Figure 3 | Central bank net purchases of gold increased sharply over the past two years (RHS gold price)



*The purchase of 604 tonnes of gold, announced by PBOC in June 2015, is averaged out over a six-year period as the specific dates of the purchases were not announced.

Notes: LHS, metric tonnes; RHS, gold price per troy ounce. Reported amounts are gold purchases that have been disclosed to the IMF or in central bank annual reports. Unreported amounts are based on recent market flows, which market analysts have attributed to China based on both the size of the purchases and the PBOC’s multi-year reporting cycle for gold.
Sources: IMF, Metals Focus, Central Bank Annual Reports, World Gold Council.

publications.banque-france.fr/en/node/478182.

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Other than the case of Russia and possibly China, gold purchases appear from central bank surveys to be motivated more by heightened geopolitical risks rather than an explicit policy of de-dollarisation. The Central Bank of Russia (CBR) launched de-dollarisation in 2014 in advance of its invasion of Crimea to seek to create "Fortress Russia". As evident in Figure 3, the CBR purchased significant amounts of gold from 2014 to 2019 in addition to euro and renminbi from its US dollar sales. China, following the imposition of sanctions on Russia, also appears to be reallocating at least a part of its reserves out of US Treasuries and into golds. As noted, the People's Bank of China (PBOC) has divested 262 billion US dollars of US Treasuries since January 2022 and the market value of its reported gold purchases amounts to about 17.6 billion US dollars and that of unreported but attributed to China gold purchases is about 78.5 billion US dollars over the same two-year period.

The main advantage of gold, that of being a physical asset, is also its main drawback. If vaulted and stored in London, New York or Switzerland, it can easily be sold or swapped for foreign currency. If vaulted domestically, it is more difficult to mobilise. The introduction of blockchain technology, however, could be used to "tokenise" gold, namely, to create a digital representation of the asset which could be easily and safely transacted. There are some interesting developments on this front, even if they still involve relatively small quantities of the metal. The World Gold Council is using blockchain technology to develop a database for all responsibly sourced and accredited gold. In due course, this could be converted into digital Standard Gold Units, which could potentially be used for many financial purposes, including collateralisation, trading, lending or investment. The United Arab Emirates are also very active on this front. The Dubai Multi Commodities Centre (DMCC) has announced a partnership with Comtech Gold to digitise the trading of gold by tokenising the precious metal.[6]

The tokenisation of assets could be extended to other commodities beyond gold. In Russia, a law has been approved which would allow digital financial assets (DFA) for cross border payments as a measure to sidestep sanctions.[7] Other assets being considered include cryptocurrencies and Central Bank Digital Currencies (CBDC), discussed in more detail below.

[6] Jamie Redman, "Dubai Multi Commodities Centre to Issue Gold Backed Tokens Using the Xinfin Blockchain Protocol", in *Bitcoin News*, 23 November 2022, https://news.bitcoin.com/dubai-multi-commodities-centre-to-issue-gold-backed-tokens-using-the-xinfin-blockchain-protocol.

[7] "Russia Signs Law Allowing Digital Asset Usage for Sanction Busting Payments", in *Ledger Insights*, 13 March 2024, https://www.ledgerinsights.com/russia-law-digital-asset-sanction-busting-payments.

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4. The internationalisation of the renminbi

4.1 The renminbi's growing role in cross-border payments

While substantially replacing the dollar with other reserve assets is unlikely in the foreseeable future, an attempt to reduce countries' exposure to the dollar and the western financial payments system is already underway.

History shows that the first step in acquiring the status of reserve currency is to promote trade invoicing.[8] This was the strategy followed by the United States at the beginning of the last century when it had become the largest world exporter but the British pound continued to be the dominant currency. At the time, the Federal Reserve sought to facilitate trade credit by US banks to encourage the invoicing of imports and exports in in US dollars. In a few years, the US dollar became an international currency bolstered by the country's leadership in world trade, technology and military power.

The key financial instrument used by the Chinese government to promote trade invoicing in renminbi is the swap between central banks. In recent years the Chinese central bank has signed swap lines with almost forty foreign central banks. Of these, 31 are in force, for about 4.16 trillion renminbi (about 586 billion US dollars).[9] With a swap line, a central bank provides the domestic currency to another central bank against the other country's currency, under the agreement that the counterpart will swap back these quantities at a specified date in the future. In this way, banks outside of China can offer loans denominated in renminbi to local firms with funds indirectly provided by their local central bank.[10] Swap lines have fulfilled the role of providing liquidity in the presence of at least partial capital controls.

After the Russian invasion and the imposition of sanctions, the use of renminbi in trade invoicing has greatly increased, as shown in a recent study of the European Bank on Reconstruction and Development (EBRD).[11] The study also shows that this

[8] Saleem Bahaj and Ricardo Reis, "Jumpstarting an International Currency", in *Bank of England Staff Discussion Papers*, No. 874 (June 2020), https://www.bankofengland.co.uk/working-paper/2020/jumpstarting-an-international-currency.

[9] Xinhua, "China's Central Bank Signs 40 Currency Swap Agreements with Foreign Counterparts", in *China Daily*, 16 February 2024, https://global.chinadaily.com.cn/a/202402/16/WS65cf5630a3108df67d6e0217.html.

[10] Hector Perez-Saiz and Longmei Zhang, "Renminbi Usage in Cross-Border Payments: Regional Patterns and the Role of Swaps Lines and Offshore Clearing Banks", in *IMF Working Papers*, No. WP/23/77 (March 2023), https://www.imf.org/en/Publications/WP/Issues/2023/03/31/Renminbi-Usage-in-Cross-Border-Payments-Regional-Patterns-and-the-Role-of-Swaps-Lines-and-531684. A few advanced economies, including Canada, the European Union, and the United Kingdom, have also signed swap lines with the PBOC, primarily to address potential financial stability risks.

[11] Maxim Chupilkin et al., "Exorbitant Privilege and Economic Sanctions", in *EBRD Working Papers*, No. 281 (September 2023), https://www.ebrd.com/publications/working-papers/exorbitant-privilege-and-economic-sanctions.

share has increased more for goods currently under EU sanctions, allegedly as a circumvention mechanism. According to recent estimates, the renminbi was used in 49 per cent of China’s cross-border transactions in Q2 2023, topping the US dollar for the first time, mainly due to more open capital markets for non-residents and increased renminbi-based settlement of trade with Russia.[12]

There is a vast amount of anecdotal evidence that confirms the Chinese effort to promote the renminbi as a way to deepen its relationships and influence across the Global South. In Latin America and the Caribbean, various international enterprises are beginning to accept renminbi for exports of their goods to China, in part also to decrease their reliance on the dollar and the United States in general. To promote the renminbi, China is also expanding lending in its currency. At the Belt and Road Initiative forum of October 2023, China’s policy banks signed a series of renminbi-denominated loan contracts with foreign lenders (Saudi Arabia, Egypt, Peru). Many of the 130 countries attending the forum belonged to the Global South, while most Western nations were not present. Another boost to the use of the renminbi in international transactions has been the creation of commodities exchanges in rare earths, metals and minerals used for clean energy transition.[13] The recent expansion of the BRICS (Brazil, Russia, India, China and South Africa) to the “BRICS+” (comprising also Egypt, Ethiopia, Iran, the UAE, and possibly Saudi Arabia) includes several commodity-exporting economies including Saudi Arabia, which is considering accepting renminbi settlement for sale of its oil. Finally, a few western countries have settled trades in renminbi.[14]

While the overall share of payments denominated in renminbi is still relatively low, there has been a pronounced increase since the imposition of Western sanctions on Russia in February 2022. According to SWIFT data, which excludes Russia payments since 2022 when Russia was banned from the system, the value of renminbi global transactions has more than doubled to 4.5 per cent as of January 2024 (Figure 4). The rate of increase of the volume of renminbi transactions on the China Cross-border Interbank Payment System (CIPS), which includes Russia, has seen even more accentuated increases (Figure 5).

[12] Noriyuki Doi and Saki Akita, “Yuan Exceeds Dollar in China’s Bilateral Trade for First Time”, in *Nikkei Asia*, 24 July 2023, https://asia.nikkei.com/Business/Markets/Currencies/Yuan-exceeds-dollar-in-China-s-bilateral-trade-for-first-time.

[13] Zongyuan Zoe Liu, “China Wants to Ditch the Dollar”, in *Noema*, 11 January 2024, https://www.noemamag.com/?p=51529.

[14] major transaction of this kind was the purchase of LNG from a French company by the China National offshore Oil Corporation (CNOOC). “China’s First Cross-Border LNG Shipment, Settled in Yuan, Completes Offloading”, in *Global Times*, 16 May 2023, https://www.globaltimes.cn/page/202305/1290796.shtml.

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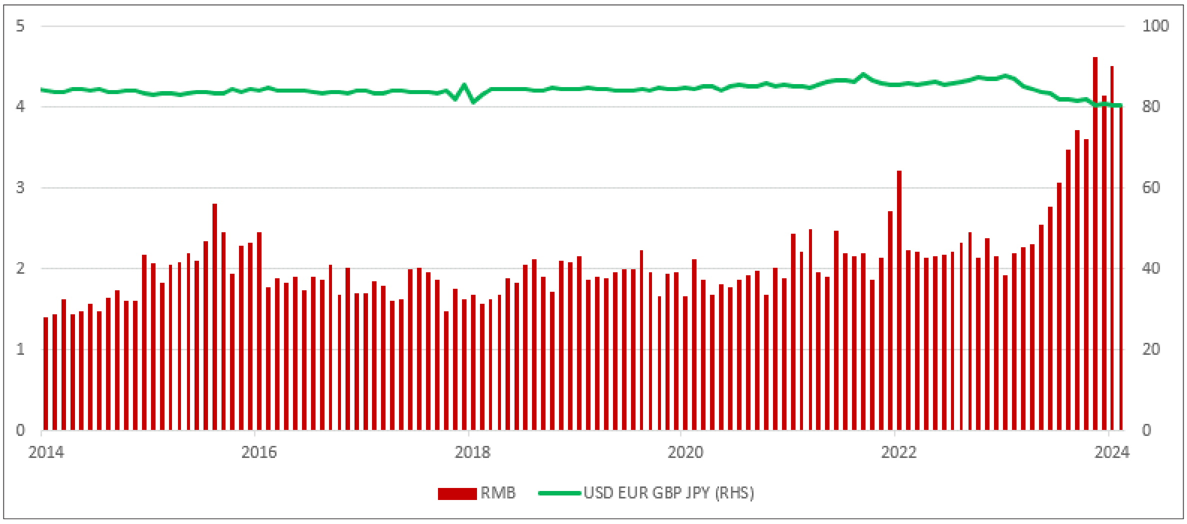
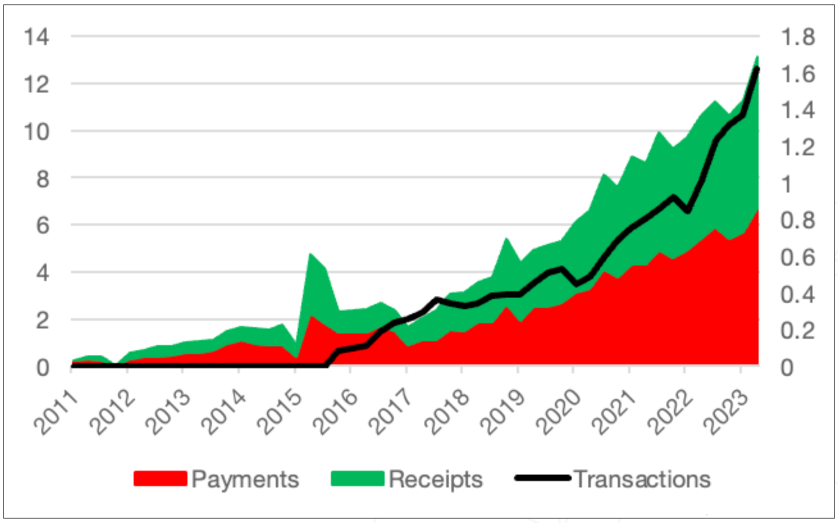
Figure 4 | Renminbi share (%) of global payments over SWIFT doubled year-on-year excluding Russia



Note: LHS, renminbi; RHS, US dollar, euro, pound sterling, yen.
Sources: SWIFT, Macrobond, Invesco. Monthly data through February 2024.

Figure 5 | And renminbi payments over the CIPS accelerated at an even higher rate (includes Russia)



Note: LHS, yuan trillion quarterly; RHS, millions of transactions quarterly.
Sources: China's CIPS, Macrobond, Invesco, data: quarterly to Q2-2023.

The increasing use of the renminbi for international payments is likely to boost its role in international reserves. Recent empirical work confirms that countries that trade more with China, such as Chile, Australia and Uruguay, hold more renminbi

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reserves as measured in terms of months of imports.[15] That said, simulations by Weiss show that a geopolitically-motivated move away from the US dollar in invoicing might diminish the US dollar's role as a reserve currency but would not destroy it.[16]

4.2 The development of alternative financial market infrastructures

Today, cross-border payments rely predominantly on networks of international correspondent banks, which act as intermediaries between domestic and foreign banks and use messaging protocols managed by SWIFT. China has sought to join this system through several initiatives over the last decade. The first step was the establishment of offshore clearing centres.[17] Another important initiative was the launch by the PBOC of its CIPS, which took off in 2017 (see Figure 5). The objective of CIPS was to increase the global use of the renminbi and reduce the country's reliance on the US dollar for international payments.[18] CIPS is a real-time gross settlement system (RTGS) that allows national and international banks to have access to the official China National Advanced Payment System.

CIPS collaborates with SWIFT messaging because its participants have a powerful incentive to use the same messaging standards as SWIFT to communicate with the global financial community.[19] However CIPS could also work 'stand-alone' if the connections via SWIFT were cut.[20] The traffic of messages in CIPS is increasing rapidly.[21] In Q3 of 2023, the number of messages increased by 31.4 per cent on a year-to-year basis, sharply accelerating with respect to the 17.3 per cent over the same period of 2022. The number of participants in CIPS is also growing (from 1,357 to 1,497 in the twelve months ending in February 2024) but it is still small compared to the more than 11,000 financial institutions using SWIFT.

It would be difficult for China and others to develop alternative international market infrastructures for securities settlement. Currently securities are held in custody and settled using a network of custodian banks and central securities depositories

[15] Barry Eichengreen et al., "Is Capital Account Convertibility Required for the Renminbi to Acquire Reserve Currency Status?", cit.

[16] Colin Weiss, "Geopolitics and the U.S. Dollar's Future as a Reserve Currency", cit.

[17] The first was in Hong Kong in 2003, followed by Singapore and London. Since 2018 clearing licenses have been given also to foreign banks, such as JPMorgan in the US and MUFG Bank in Japan. The renminbi-denominated deposits were distinguished between the one held offshore (called CNH) and those her onshore (CNY). A small liquidity pool of CNH developed.

[18] SWIFT, "CIPS Accelerates the Internationalisation of the RMB", in *SWIFT News*, 28 October 2016, https://www.swift.com/swift-resource/44986/download.

[19] Their collaboration is based on a memorandum of understanding agreed between the two in 2015.

[20] The main difference is that SWIFT is a messaging system, which allows banks to communicate with each other, but does not move funds. CIPS, instead, actually moves funds, similar to other national payments systems, and uses either CIPS or SWIFT for the corresponding messages.

[21] Emily Jin, "Why China's CIPS Matters (and Not for the Reasons You Think)", in *Lawfare*, 5 April 2022, https://www.lawfaremedia.org/article/why-chinas-cips-matters-and-not-reasons-you-think.

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(CSDs).[22] The main infrastructures for the settlement of international securities are the International Central Securities Depositories (ICSDs), the most important of which are part of the Euroclear group – 38 trillion euros of assets under custody (AUC) – and Clearstream in Luxembourg – 18 trillion euros of AUC. Most emerging market economies use both the international depositories and the ICSDs, the latter especially for central banks' investment of foreign reserves and to attract foreign investors into their domestic securities markets.

While past attempts to create a clearing and settlement system in Asia to rival Euroclear or Clearstream have failed, multiple initiatives have emerged in recent years. Reportedly, the Moscow Exchange is seeking to create a separate international depository for the BRICS.[23] In Hong-Kong, the Hong Kong Monetary Authority (HKMA) has publicly outlined its ambition to turn the Central Moneymarkets Unit (CMU) into an "ICSD for Asia". The UAE is actively promoting Dubai as an international financial centre and has copied some of the institutional arrangements of Western states. For instance, just as the Bank for International Settlements (BIS) has the Committee on Payment and Market Infrastructure, the Arab Monetary Fund (AMF), headquartered in Dubai, has set up an Arab Committee on Payment and Settlement Systems. The AMF has also launched a cross-border payment system called Buna which has the important feature of providing settlement services in multiple currencies. It would be natural to expect that the UAE would also consider launching an ICSD in Abu Dhabi.

It is too early to say whether these projects have any chance of being successful. The current "Western" infrastructures have entrenched advantages, including multiple currency settlement capacity and powerful economies of scale and network externalities: the larger the number of users, the lower the unit costs and the higher the capacity to attract additional users. China is well aware of the complexity and importance of existing infrastructures to access international capital markets, as evidenced by its continued strong interest in Euroclear, where it increased its capital share from 4.26 per cent in 2021 to 7.25 per cent, the fourth largest shareholding.[24]

Russia and China's leaders, Vladimir Putin and Xi Jinping, have recently announced their intention to build a "financial infrastructure that ensures reliability of

[22] The main custodians, whose primary role is to offer safekeeping services to clients, are BNY Mellon, State Street, JPMorgan and Citi. CSDs offer a number of additional services beyond custody. A distinction is often made between "Issuer-CSDs" and "Investor-CSDs" The so -called "Issuer-CSDs" are those used by government entities or private companies to deposit the securities they issue. Most counties have their own CSD and some more than one." Investor-CSD" are used by investors to custody the securities originally held in an "Issuer-CSD", made possible by linkages between them.

[23] "Moscow Exchange Proposes to Create International Depository Based on BRICS", in *Interfax*, 16 June 2023, https://interfax.com/newsroom/top-stories/91509/.

[24] Euroclear website: *Top 20 Shareholders (as of 13 November 2023)*, https://www.euroclear.com/investorrelations/en/top-20-shareholders-Euroclear-Holding-SA-NV.html. The participation is of the State Administration of Foreign Exchange (SAFE), a unit of the Chinese central bank, through a separate company, Kuri Atyak Investments Ltd., which holds a seat on Euroclear's board.

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payments”.[25] And this may dovetail with technology changes well underway, whereby cross-border payments are settled directly by “fintech” companies outside the traditional payments network of correspondent banks and SWIFT. Furthermore, central banks have been developing their own platforms, which would allow the more efficient settlement of cross border payments. China has already launched the e-yuan and successfully tested the prototype of a multiple CBDC network with the HKMA, the Central Bank of the UAE and the Central Bank of Thailand under Project mBridge.[26]

Conclusion

Our analysis confirms that there are no immediate risks of de-dollarisation in the international financial system. The US dollar continues to hold its dominant position and the main infrastructure for securities settlement can scarcely be challenged by new entrants. Reserves denominated in renminbi, the currency of the world’s second-largest economy, are still a very small share of global reserves. And China’s continued reliance on capital controls, its managed exchange rate and global balance of payments surpluses constrain the renminbi’s potential as a foreign currency reserve asset.

The search for alternatives to traditional reserve and payments currencies, however, is underway. Central bank net purchases of gold have been accelerating and the price of gold has reached record highs. Since the start of Russia’s war on Ukraine and the imposition of sanctions, the renminbi has also been increasingly used in trade invoicing and, in particular, cross border payments.

Digitalisation and the rapid development of tech-enabled global payments are creating alternative routes to the current payments system. While digitalisation could in principle further integrate financial markets and reduce transaction costs, the result could also be a loss in the transparency of the global payment system and of the capacity for the West to impose financial sanctions. Going forward, central bank projects to develop multiple CBDC platforms could also offer a local currency alternative to a dollar-based payments’ system. Finally, digitalisation could widen the range of assets to be used as reserves, as the recent experiments with the tokenisation of gold has shown.

The stepping-up of sanctions, such as the seizing of Russia’s foreign currency reserves, could amplify concerns, especially among countries of the Global

[25] “Putin and Xi Reject US ‘Interference’, Praise Their Own Ties and Trade - Kremlin”, in *Reuters*, 8 February 2024, https://www.reuters.com/world/putin-xi-reject-us-interference-praise-their-own-ties-trade-kremlin-2024-02-08.

[26] BIS Innovation Hub, *BIS Project mBridge. Experimenting with a Multi-CBDC Platform for Cross-Border Payments*, October 2023, https://www.bis.org/innovation_hub/projects/mbridge_brochure_2311.pdf.

South, about the safety of their assets in Western financial institutions. Many of these countries have close economic, financial or even national-security ties with the United States and Europe but also maintain relations with countries that have a potentially antagonistic relationship to the West, which they perceive as increasingly adopting double standards.

Throughout recorded history, high politics has always played a major role, beyond economic and financial considerations, in shaping the evolution of the monetary system. Countries are now using currencies and payment networks not only for economic but also for political reasons and as part of emerging groups such as the expanded BRICS+. Of course, this group is very heterogeneous. India has long wanted to chart its own course as a founding member and leader of the original Non-Aligned Movement. However, it now faces high tensions with China, Saudi Arabia and other major regional oil exporters are also somewhat “in between” west and east. Their central banks maintain sizeable US dollar reserves and they have deep security ties with the United States. Yet their main trading partners are China and, to a lesser extent, India.

The vicious circle between “weaponisation” of money as a way to punish a state and “fragmentation” as a way to protect oneself needs to be addressed because there is a real risk of a bifurcation or segmentation of the global financial system. The measures taken today regarding the Russian central bank reserves as a response to the unequivocal violation of Ukraine’s international legal rights will set an important precedent, with implications for the ordering of the international financial system. Any such measures should be designed in a way that encourages confidence and continued participation in an integrated global economic and financial system, including sovereign immunity, even if a multipolar one.

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