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POSITIONS AND PROSPECTS OF EMERGING MARKET ECONOMIES' CURRENCIES

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Abstract. Over the past two decades of the 21st century, there has been an increase in the role of the currencies of emerging markets in the global foreign exchange market, but their positions in the international monetary system have not significantly changed. The article demonstrates the continuing gap between the role of the leading emerging market economies in the global economy and finance and the position of their currencies in the international monetary system. This gap is driven by lower liquidity premiums for the currencies of EME countries, relatively underdevelopment of their financial systems and greater financial instability, restrictions on the placement of securities denominated in national currencies on international financial markets, as well as geopolitical factors (including the risks of imposing sanctions regimes by the developed countries). It is shown that the internationalization of the EME currencies is facilitated by such factors as internal financial stability, the relative development of national financial markets and a significant role of issuing countries in world trade. On the example of China, the relative success of the policy of internationalization of the yuan is shown, on the example of Mexico and Russia, the role of participation in regional integration associations to expand the external circulation of national currencies. There is an increase in the role of geopolitical factors in determining the positions of individual EME currencies, especially since 2022. The scenario of fragmentation of the international monetary and financial system is considered, which implies a relative weakening of the positions of current leading world currencies with a relative strengthening of the positions of the individual EME currencies (primarily Chinese yuan). Measures are proposed to strengthen the positions of EME currencies in the new geopolitical conditions: activation of interaction processes in regional and mega-regional associations, formation of payment and settlement systems within them in national currencies using digital technologies, creation of regional markets for securities denominated in national currencies, the conclusion and activation of multilateral currency swap agreements between the central banks of EME countries.

Keywords: international monetary system, global foreign exchange market, emerging market economies, currency internationalization, currency hierarchy.

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ПОЗИЦИИ И ПЕРСПЕКТИВЫ ВАЛЮТ СТРАН С ФОРМИРУЮЩИМИСЯ РЫНКАМИ

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Аннотация. Сохраняется разрыв между ролью ведущих стран с формирующимися рынками в мировой экономике и позициями их валют. Показано, что интернационализации национальных валют способствуют такие факторы, как внутренняя финансовая стабильность, относительная развитость национальных финансовых рынков и значимая роль в мировой торговле. На примере Китая показана относительная успешность политики интернационализации юаня, на примере Мексики и России – роль участия в региональных интеграционных объединениях для расширения внешнего обращения национальных валют.

Ключевые слова: мировая валютная система, мировой валютный рынок, страны с формирующимися рынками, интернационализация валют, иерархия валют.

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Over the past two decades, the positions of emerging markets and developing countries have been strengthening in the global economy. According to the International Monetary Fund (IMF), their share in world GDP increased from 20.9 to 41.7% (at current exchange rates) and from 43.6 to 57.9% (at purchasing power parities, PPP) during the period 2000–2021. However, they still do not play even the second, but the third and fourth roles in the international monetary system (IMS). From 2001 to 2019[1], the cumulative share of the nine most traded currencies in this group[2] grew in the global foreign exchange market from 5.9 to 17.6%[3], which clearly cannot be compared to their new role in the global economy[4]. Besides, their positions in the IMS have hardly changed, despite the growth in the share of emerging market currencies in the turnover of the global foreign exchange market (except for China).

Let us consider: 1) what determines the gap between the role of emerging markets in the global economy and in the IMS and 2) what are the reasons for the success of individual states in the internationalization of their currencies?

CURRENT SITUATION

The modern IMS is usually considered in the form of a pyramid, where the US dollar is on the top. The role of other currencies is evaluated differently [1; 2; 3, pp. 130-133]. One of the central elements in classifications is the ability of individual currencies to perform the functions of money in the global economy. Particular attention is paid to the hierarchy of currencies in the international political economy and the Post Keynesian theoretical tradition.

In the Post Keynesian tradition, emerging market currencies are characterized as short-term investment currencies. They are distinguished from the currencies of developed countries by a lower liquidity premium. As compensation, some countries offer higher interest rates. It may lead to an increase in demand for these currencies, but mainly from speculative foreign capital. Capital outflow and increased volatility of such currencies are very likely outcomes in the longer term. In general, the strengthening of the positions of emerging markets currencies, in the global hierarchy of currencies, does not occur [4].

The positions of currencies can be assessed by a combination of various indicators: the share in the turnover of the global foreign exchange market, the share of international foreign exchange reserves denominated in that currency, the share of foreign trade contracts concluded (here it is necessary to distinguish between the currency of the price and the currency of payment), and the share of international assets denominated in that currency (loans or bonds) [5].

The indicator of the share in trading volumes on global foreign exchange market in the currencies under consideration has grown in the 21st century. This is mainly due to a sharp increase in the share of the Chinese yuan from 2007 to 2016. Now it accounts for about 25% of the total share of currencies of emerging market countries under consideration, and together with the Hong Kong dollar – up to 44.5% (2019) [source 1]. However, there have been no significant changes in the positions of the countries under consideration in the IMS. The only exception is the inclusion of the renminbi in the basket of special drawing rights (SDR) of the IMF in 2016, which allowed this currency to become a tool for nominating foreign exchange reserves after the US dollar, Euro, Japanese yen, and pound sterling. The share of international reserves denominated in

[1] The latest statistics available on the global foreign exchange market at the time of writing relate to the three-year review of the Bank for International Settlements for 2019 [source 1].

[2] Currencies, the share of which exceeded 1% in the turnover of the global foreign exchange market in 2019, are among the most traded ones. These include the Chinese renminbi, Hong Kong dollar, Korean won, Mexican peso, Indian rupee, Russian ruble, South African rand, Turkish lira, and Brazilian real. It should be noted that, unlike a number of other classifications (for example, the IMF), this classification includes the Republic of Korea and Hong Kong among the emerging markets.

[3] The total share of all the currencies in the global foreign exchange market is 200%, since two currencies participate in each transaction.

[4] These nine countries accounted for 29.8% of global GDP at current exchange rates and 37.5% at PPP in 2021.

renminbi was 2.8% at the end of 2021 (1.1% at the end of 2016)[5].

FACTORS DETERMINING CURRENCIES' POSITIONS

There are three main approaches to identifying factors behind the role of individual currencies in the IMS: market, instrumental, and geopolitical [6]. The first one is based on the assessment of the currency liquidity, as well as the confidence in it on the part of economic agents. The instrumental approach involves the implementation of a specific policy aimed at the strengthening of the national currency position in the IMS. The geopolitical approach emphasizes the use of international organizations to increase the competitiveness of a currency. Mainstream economists focus on market factors. Adherents of international political economics and the Post Keynesian approach emphasize the importance of political decisions [4].

From the standpoint of market factors, the demand for a currency is determined by the volume of transactions with it (which depend on the size of the country's economy and cross-border operations with its participation) and demand from participants in financial transactions (in particular, in order to diversify risks). The narrowness of national financial markets [7, p. 4], as well as increased risks due to high inflation and instability of this currency exchange rate, may act as restrictions.

The demand for transactions with national currencies is determined by the scale of economies and the degree of their participation in international trade, as well as the international movement of production factors. China and India show the largest gap between their shares in global GDP and the role of their currencies in the global market. In general, the positions of countries in terms of their share in global exports reflect the positions of their currencies in the global foreign exchange market. It confirms the thesis that the main role of emerging market countries in the internationalization of their currencies is played now by foreign trade, not an international capital movement.

Given the current role of the financial sector in the global economy, the development of markets for financial instruments denominated in national currencies is of particular importance [8, p. 10]. This is where most emerging market countries are still significantly lagging behind developed ones. In particular, there is a large gap between the market of domestic and international debt securities, and among international securities denominated in foreign and national currencies. Relatively significant issues of international debt securities in national currencies take place only in Hong Kong[6], China, and Mexico. In general, the so-called *Original Sin* problem remains relevant for all these countries[7].

There are examples of debt issuance in the currency of one emerging market economy placed in another country from the same category. For example, securities in Brazilian reals issued in Argentina and Mexico ($255 million and $178 million accordingly), and Mexican peso securities issued in Chile ($410 million) were circulating in Latin America in 2011 (albeit in a small volume) [9, p. 7].

In general, one can say that the basis for the internationalization of national currencies in the form of international securities denominated within their territory has not yet been formed. Although the total volume of international debt securities denominated in national currencies of considered countries grew by 87.8% over the period from 2010 to 2021, it remains insignificant ($72.3 billion at the end of 2021[8]). This is partly due to the relatively high risk premium for debt securities denominated in national currencies, partly due to the limitation of their supply. However, in a number of countries, non-residents are quite active in the market of domestic securities denominated in national currencies. For example, in the Russian Federation, their share in the domestic government bond market (OFZ) at the end of 2021 was about 20% (before the sanctions were imposed in 2022), and at its peak (in early 2020) was close to 35%[9]. Lahet and Prat note the positive impact of financial derivatives on the use of emerging market economies' national currencies as currencies for nominating debt instruments [10].

[5] Calculated based on IMF data. Available at: https://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4 (accessed 16.08.2022).

[6] It should be noted that Hong Kong has a currency board arrangement against the US dollar, thereby significantly reducing foreign exchange risks when placing debt obligations in the national currency.

[7] Its meaning lies in the fact that in this group of countries, external borrowings are carried out mainly in foreign currencies.

[8] For comparison: according to the BIS, at the end of 2021, international debt securities issued by residents denominated in Canadian dollars were in circulation in the amount of 53.1 billion, in Australian dollars – 47.2 billion. Available at: https://www.bis.org/statistics/secstats.htm?m=2615 (accessed 16.08.2022).

[9] According to the Bank of Russia. Available at: http://cbr.ru/statistics/macro_itm/svs (accessed 16.08.2022).

A feature of international capital flows in emerging markets is also the active use of so-called "round-trip" capital flows and offshore jurisdictions [11, p. 19]. An important role in increasing external demand for the national currency is played by achieving financial and economic stability, namely, persistently low inflation rates, the absence of large-scale fluctuations in the exchange rates of national currencies, and the sustainability of external debt.

Over the past 20 years, emerging market economies have managed to reduce inflation rates and bring them closer to the global average values typical for 2017–2020. Previously, inflation, particularly in Russia, India, and South Africa, steadily exceeded the global average. It remains at an extremely high level in Turkey. However, in 2021, inflation began to accelerate throughout the global economy.

The high volatility of the exchange rate remained in the group of countries under consideration (primarily Russia, Brazil, Turkey, and South Africa), despite the decline in inflation rates. Brazil, India, South Africa, and China were characterized by a high burden from the standpoint of public debt. Hong Kong was distinguished by the greatest financial and economic stability, which partly explains the good position of the Hong Kong dollar in the global foreign exchange market. The figures of the Republic of Korea and the People's Republic of China were also quite good.

The depth and liquidity of national financial markets are reflected, in particular, by the ratios of domestic bank loans for the private sector and the volume of trading in the stock market to GDP[10]. Hong Kong had the highest level of development of financial markets, followed by the Republic of Korea and mainland China with similar figures. The other countries are characterized by a relatively low level of development of financial markets (with the exception of the stock market in Turkey and the banking sector in South Africa), which may partly explain the weaker positions of their currencies in the IMS. Thus, the leadership of China, including Hong Kong, and the Republic of Korea in the internationalization of national currencies is justified by a high level of financial stability and the development of financial markets.

Within the framework of the market approach, it is obvious that the prospects for strengthening the positions of emerging market economies in the IMS are quite remote. It will take time to gain confidence in their currencies. Nevertheless, this approach points to objective limitations of the effectiveness of instrumental and geopolitical approaches. Among those are the following: first of all, the role of issuing countries in the global economy (the size of GDP, shares in international trade and cross-border capital flows, positions in global financial markets, etc.) [12, p. 3], the need to achieve financial stability and a relatively high level of development of national financial markets.

There are also factors external to national economies that affect the degree of currency internationalization. These include changes in the dynamics of the global economy and global financial markets. The crisis phenomena have a negative impact on the positions of national currencies of the emerging market economies in the IMS. Among such phenomena, one can single out the global financial and economic crisis of 2008–2009, the policy of quantitative easing, the drop in oil prices in the global market (2014–2015), the *COVID-19* pandemic, geopolitical and geo-economic shifts related to the special military operation of the Russian Federation in Ukraine in 2022.

It should be noted that the expansion of the sphere of national currency external circulation is associated with both benefits and costs. The main benefits include: overcoming the problem of Original Sin and thereby improving the conditions of external borrowing; reducing transaction costs; reducing foreign exchange risk in foreign economic operations; obtaining additional income from seigniorage [10; 12, p. 4; 7, p. 3]. On the other hand, the economy of the country becomes more susceptible to external shocks. In particular, portfolio investment flows are growing, increasing the dependence of the internal financial system on external financing [7, p. 3], and the effects of external sanctions pressure are growing. The exchange rate of the national currency begins to be determined not only in the domestic but also in foreign markets, which increases its volatility.

ECONOMIC POLICY

There are different approaches to the need to stimulate the internationalization of currencies by economic policy measures. The approach, which can be called market-based, consists of pursuing foreign exchange and financial liberalization by the government and policies aimed at ensuring domestic economic and financial stability. The rest of the work will

[10] In emerging market economies, the indicator of trading volume in the stock market reflects the real situation better than the level of capitalization (the latter takes into account all stocks listed in the stock market, but the liquidity of many of them may be low).

be done by the market. Another approach involves the use of active measures to promote the national currency in foreign markets. China is an example of the latter. The policy of strengthening the internal factors of currency internationalization implies measures to stimulate economic growth, reduce inflation, and develop the country's financial system.

Let us focus on the characteristics of monetary policy and exchange rate regimes among the analyzed countries and territories. All of those apply the inflation targeting regime, with the exception of the PRC (with the official regime of targeting the money supply and implicit targeting of the exchange rate) and Hong Kong (with the regime of currency board). At the same time, only two countries (Mexico and Russia[11]) officially adhere to the free-floating exchange rate regime [14, pp. 14-16]. An analysis of the actual dynamics of exchange rates allows concluding that India and the Republic of Korea also maintain active exchange rate policy. Thus, some progress in terms of currency internationalization is demonstrated by countries with both implicit exchange rate regulation (China, India, the Republic of Korea) and with an inflation targeting regime and a floating exchange rate (Mexico).

The removal of restrictions on cross-border capital movement is considered as the main pre-condition for expanding the sphere of external circulation of national currencies. However, the situation is ambiguous. Thus, China and India maintain a fairly wide range of foreign exchange restrictions on cross-border capital movement, and in the Russian Federation, from mid-2006 to early 2022, a formally free regime of cross-border capital movement operated. The full-scale lifting of restrictions is not so important at the initial stage of the internationalization process. Moreover, some of those allow for the protection of currencies from external shocks.

The following can be used as special economic policy measures to increase the international competitiveness of national currencies: partial transfer of foreign trade settlements into the national currency; support of issuance of financial instruments in national currencies traded in foreign markets; assistance in the international expansion of national financial institutions (especially development banks); lending to foreign countries in national currency [12, p. 3].

Let us consider the measures applied by the PRC as part of renminbi internationalization policy.

1. The main focus of the internationalization policy at the first stage was made on the use of the renminbi in foreign trade (as the currency for nominating transactions and making settlements). All restrictions on its use in foreign trade were abandoned in 2012. At the same time, bilateral agreements on settlements in national currencies were concluded with some countries (primarily with neighboring ones).

2. Limitations on the use of the renminbi in capital transactions were removed gradually. Thus, a pilot project on settlements in yuan within the framework of foreign direct investment was launched in 2011.

3. China uses its projects (One Belt One Road, Asian Infrastructure Investment Bank) to expand lending to other countries in the renminbi.

4. China actually used a number of offshore jurisdictions (with a wide geographical range so that they covered the main regions of the global economy) to conduct operations with its currency. Hong Kong is the most important one, so it is logical to consider the position of the Hong Kong dollar in the IMS as a kind of reinforcement of the Chinese renminbi position. Operations with the offshore renminbi are carried out by authorized banks, where the vast majority are Chinese.

5. The system of Cross-Border Interbank Payments and Settlements *(CIPS)* was launched as an alternative to *SWIFT* in 2015 [15]. The importance of this step became obvious in 2022, when the aggravation of the geopolitical confrontation increased the risks of possible disconnection from the *SWIFT* system.

6. China actively uses the system of bilateral foreign exchange swap agreements in the renminbi between its People's Bank and central banks of other countries. At the end of 2020, 40 such agreements were concluded, and the total position of open foreign exchange swap lines was 3.99 trillion renminbi [16, p. 21].

One can talk about China's purposeful policy of renminbi internationalization. However, it is not yet possible to bridge the gap between the economic and financial potential, on the one hand, and the positions of the Chinese yuan in the IMS, on the other.

Participation in the processes of regional economic integration can be singled out as a separate direction of the state's policy to increase the role of the national currency in foreign markets. So, in particu-

[11] In the Russian Federation, the ruble exchange rate has actually been regulated by fiscal policy measures within the framework of the budget rule since 2017 [13], strict foreign exchange restrictions have been in effect since March 2022.

lar, the relatively high position of the Mexican peso in the IMS can be partly explained by Mexico's participation in NAFTA, and now – in *USMCA*. The other side of such internationalization is a steady current account deficit of the balance of payments, as well as increased instability of the country's economy and a decrease in the effectiveness of the national monetary policy. Brazil failed to realize its potential as a regional leader in Latin America to strengthen the external position of the national currency [11, p. 15].

The Russian ruble within the EAEU can be mentioned as a positive example of expanding the national currency external circulation sphere due to its use in foreign trade transactions within a regional integration. Its share in incoming payments for goods and services within the EAEU increased from 53.8% in 2013 to 70.4% in 2021, and in outgoing payments – from 60.7% to 73.6% over the same period[12]. However, such achievements within the EAEU were not enough to strengthen the ruble's position in the global market.

PROSPECTS

From the standpoint of the geopolitical approach, significant changes in the positions of currencies of emerging market economies in the IMS can only occur with the strengthening of their positions in international economic institutions, especially financial ones [6]. Formally, it was partly achieved when the leading role in shaping the international monetary and financial system' reform agenda was transferred to the *G20* after the global financial and economic crisis of 2008–2009. However, in fact, the main agenda is still being formed by developed countries. The BRICS association, which in many ways was designed to express the joint position of emerging market countries in the processes of global economic management, has not yet coped with this task. A significant strengthening of the role of emerging market countries in the decision-making mechanisms of the IMF and the World Bank Group still seems unlikely. The formation of their coordinated position within the *G20* remains a key task.

The basis of such a position could be the construction of protective mechanisms against external shocks arising in the 21st century, mainly from developed countries, as well as from the spread of "contagion effects" between emerging market economies, which took place in the second half of the 1990s – early 2000s. The establishment of set of measures for regulating international capital flows at the national and global levels in the form of foreign exchange restrictions on the cross-border capital flows, macroprudential policy measures, or their combination could be the solutions to this problem [17, p. 26]. The expansion of opportunities for the simultaneous implementation of inflation-targeting policies and exchange rate regulation could be an advantage for emerging markets.

However, there are objective limitations to such solutions. They are related to the differences in the positions of developed countries, on the one hand, and emerging and developing countries, on the other. It is impossible to create global regulatory mechanisms without a collective decision. In addition, the tasks set by the emerging market countries themselves are different: while China is striving to make the renminbi one of the leading currencies at the global level, the currencies of other countries under consideration will likely continue to compete with each other within the 3–4 levels of the currency hierarchy.

Opportunities for the global strengthening of the ruble's position have sharply decreased due to unprecedented sanctions pressure on Russia in 2022, although additional opportunities have appeared to promote settlements in rubles in certain commodities (primarily energy and food markets) and regional (Post-Soviet space, a number of other friendly countries) markets. The sanctions had two more important effects: on the one hand, they complicated the coordination of positions for emerging markets countries, on the other hand, they dramatically increased the role of geopolitical factors and national security considerations when such countries make decisions in the currency sphere.

The practice of issuing bonds denominated in the currencies of emerging market countries by both national governments and regional and global development institutions seems promising when transactions with financial instruments are prevailing in the global market. The involvement of international financial institutions in the organization of these issues could stimulate interest in the currencies of emerging markets on international financial markets. The purpose of such issues may be both to finance projects in the respective countries and to motivate the overall development of bond markets in developing countries. The highest credit rating of such issues ensures the possibility of their use as part of international reserves. It could further contribute to the growth in demand for emerging markets currencies with the widest circula-

[12] According to the Bank of Russia. Available at: https://www.cbr.ru/statistics/macro_itm/svs (accessed 16.08.2022).

tion sphere. However, the fragmentation of the IMS may act as an obstacle to the involvement of global development institutions in this process.

In this regard, the activation of regional and mega-regional integration associations with the participation of emerging market economies may be of particular importance for expanding the circulation of their currencies. In this case, integration associations are understood in a broad sense, including, in addition to traditional integration groupings, new formats of interactions that go beyond individual regions and unite countries with emerging markets, such as BRICS, the Regional Comprehensive Economic Partnership, the Chinese One Belt, One Road initiative, etc.

Possible areas for cooperation development could be the expansion of the practice of settlements in national currencies, the use of national currencies for credit operations in regional development banks, and the creation of regional bond market initiatives (following the example of the Asian project[13]). Currently, the idea of creating a bond fund has also emerged within the framework of the BRICS association [19].

One can highlight separately the practice of creating foreign exchange reserve pools (the conclusion of swap agreements to support the exchange rates of national currencies). An example is the multilateral Chiang Mai Initiative launched within East and Southeast Asia (by the ASEAN+3 countries). This cooperation provided for the creation of a mutual support system for national currencies (initially based on the use of bilateral dollar swap lines, and later on the use of a multilateral pool of foreign exchange assets), as well as short-term liquidity of participating countries in international settlements without the need to appeal to the IMF. The currency pool of the agreement amounted to $240 billion after the 2014 reform[14]. A pool of conditional foreign exchange reserves, close in the essence to the mechanism of the Chiang Mai Initiative, has also been created within the framework of BRICS.

BRICS is considering projects to create a payment system in national currencies. The relevance of the topic has increased dramatically due to the sanctions imposed on Russia in 2022. It was announced that the creation of a supranational BRICS settlement currency based on a basket of national currencies is worked out [source 2].

The geopolitical situation that developed in 2022 and the unprecedented sanctions imposed on Russia by unfriendly countries significantly complicate the opportunities for the internationalization of the ruble based on a market approach. The main barrier is the actual closure of global financial markets for Russian assets. At the same time, due to the sharp restriction of the use of the world's leading currencies, a kind of opportunity window has opened for expanding the external circulation of the ruble in the foreign economic operations of the Russian Federation, relying on instrumental and geopolitical approaches. An important step in this direction was the transition in payments for energy carriers to rubles. Further steps could be settlements with friendly countries in national currencies, placement of financial assets denominated in rubles in these countries, and activation of monetary and financial integration processes within the EAEU.

CONCLUSIONS AND RESULTS

The gap remains between the economic and, partly, financial potential of emerging market countries, on the one hand, and their positions in the IMS, on the other. It is caused both by economic factors, including the lack of a significant volume of instruments denominated in the national currencies of these countries in the global financial markets, and by political factors related to their limited role in the processes of global economic governance.

Among the currencies of emerging markets, the currencies of countries with better financial stability and more developed national financial systems that play a relatively more significant role in global trade have taken more favorable positions in the global foreign exchange market. The generally successful policy of China aimed at increasing the degree of renminbi internationalization should be noted.

The events of 2022 may change the situation. There is already an acceleration of inflation and a slowdown in the dynamics of the global economy. In the future, the fragmentation of the IMS is possible, which will lead to a decrease in demand for leading currencies and an increase in the currencies of emerging markets (primarily the renminbi). In such conditions, the positions of regional and mega-regional associations will

[13] The project for the development of the regional bond market is being implemented in East and Southeast Asia. Within the framework of this project, the Asian Bond Fund-2 was established in 2005. This fund accumulates part of the foreign exchange reserves of central banks for investments in bonds denominated in national currencies [18].

[14] Available at: https://aric.adb.org/initiative/chiang-mai-initiative (accessed 16.08.2022).

strengthen. Within their framework, there will be the formation of their own payment and settlement systems in national currencies (primarily based on the central banks digital currencies, including multilateral ones), regional bond markets in national currencies (with the involvement of development banks), a network of foreign exchange swap agreements to support the exchange rates of national currencies.

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