

# **International Payment Flows and the Potential of the RMB as a Significant Payment Currency**

**Edwin L.C. Lai**

Hong Kong University of Science and Technology

May 2020

## **Summary**

The gravity model can explain the bilateral inter-country payment flows by currency very well. The economic sizes of the origin and destination countries significantly and positively affect bilateral payment flow denominated in any given currency, while distance and other factors that increase trade costs or information friction significantly and negatively affect the bilateral payment flow denominated in any given currency. In addition, the GDP of the issuing country, the strength of trade relationship between each country and the issuing country, the co-movement between the exchange rates of each country and the currency in question, significantly and positively affect the bilateral payment flow denominated in the currency. Most importantly, financial development and openness of the issuing country positively affect the bilateral payment flow denominated in the currency between two countries. We carry out two sets of counterfactuals, both of which demonstrate that the increase in China's level of financial development & openness would be much more important than the increase in the economic size of China for the RMB to become a significant global payment currency.