



# Advance Journal of Econometrics and Finance

## Vol-4, Issue-1, 2026



Online ISSN

2959-8990

Print ISSN

2959-8982

<https://ajeaf.com/index.php/Journal/About>

Name of Publisher: SCHOLAR CRAFT EDUCATION & RESEARCH HUB

Review Type: Double Blind Peer Review

Jurnal Frequency: Quarterly Research Journal

### Financial Market Weaponization? US Secondary Sanctions and Chinese Bond Markets

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	Abstract
<p><b>Anam Batool</b> National University of Modern Languages (NUML), Islamabad, Pakistan Email: <a href="mailto:banam5058@gmail.com">banam5058@gmail.com</a></p>	<p>Background: U.S. secondary sanctions, and weapon-ization of financial markets overall have become an important geopolitical instrument, impacting global capital flows as well as financial market behaviors. The bond markets in China have become a center of interest in that they have grown and developed amid pressure of the outside world or sanctions. The dynamics of this interaction is crucial in understanding the dynamics of global finance that is changing. Purpose: This paper will examine the effects of U.S. secondary sanctions in Chinese bond markets and discuss the effects of sanctions on market behavior, outward foreign investment, and market volatility. Method: Mixed-method design was used and quantitative econometrics and qualitative policy analysis were used. The research took the data of the world financial databases to analyze bond yields, foreign investment flows, and exchange rates volatility. Whether, there were also policy texts and case studies which were analyzed to give a context to the empirical findings. Findings: The researchers conclude that U.S. secondary sanctions have a noteworthy effect on bond yields and foreign investment and market responses are evident in the negative correlation of market responses to the sanctions periods. The Chinese bond markets are resilient with sanctions varying with liberalization. The volatility of the exchange rates enhanced in the enforcement of the sanctions, which means that the economy was more unstable. Conclusion: The findings indicate the intricate association between the sanctions and the financial market performance. Although the liberalization of the bond market in China provides the alternatives to the U.S. hegemony in the financial sector, the role of secondary sanctions is one of the essential issues determining the movement of capital and investor confidence across the international borders.</p>
<p><b>Keywords:</b></p>	<p>U.S. Secondary Sanctions, Chinese Bond Markets, Financial Market Weaponization, Capital Flows, Exchange Rate Volatility, Foreign Investment</p>



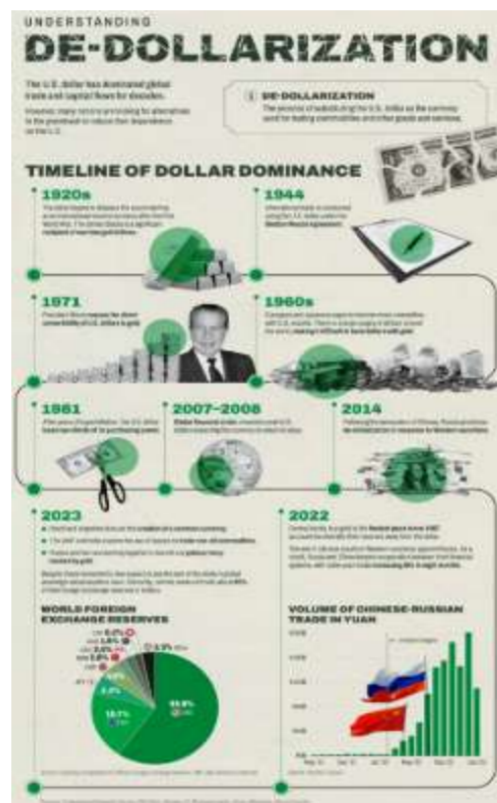
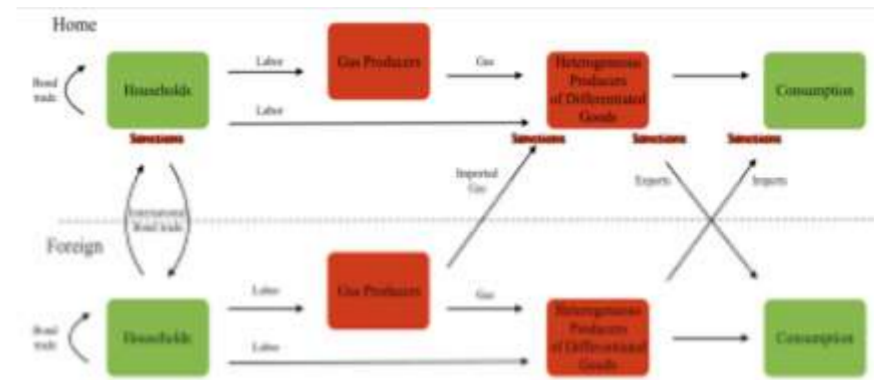
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### Introduction

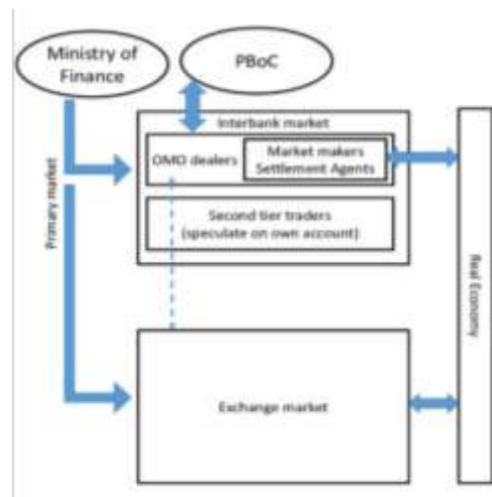
The global financial system after the Cold War has gradually turned out to be a battlefield of geopolitics, in which states have turned to economic instruments not just to conduct an economic policy, but also to coerce strategies. A notable manifestation of this change is the weaponization of financial markets, a phenomenon where the instruments of sanctions, capital controls, and restrictions to access facilities of important financial infrastructures are used to advance foreign policy goals that were not aimed at pure economics. The concept of financial market weaponization is based on the notion that states with such a strong position in the global economic system can use their centrality to impose disproportionate influence on the economic decisions and actions of other actors and thus transform economic interdependence into a strategic strength or weakness.

In this regard, the United States has led the way in applying secondary sanctions to bring its domestic regime of sanctions far beyond its territorial borders. In contrast to primary sanctions, which directly cause U.S. persons or entities to be prohibited to conduct any economic transactions with a target, secondary sanctions are punitive measures applied to foreign firms and financial institutions which undertake any economic transactions with a target, regardless of their direct nexus with the United States. This extra-territorialism of the U.S. law takes advantage of the centrality of the U.S. dollar, dollar clearing systems, and its institutional structure to impose compliance and coercive influence on the rest of the world.



The U.S. secondary sanctions have a strategic leverage because of the unparalleled significance of the U.S. dollar in world finance. Dollar-denominated transactions are regularly transacted through the U.S. financial structure or through U.S. banks, which provides U.S. regulatory bodies with jurisdictional contacts to enforce compliance. Due to the fact that most of the cross-border financial transactions are dollar-based, foreign institutions are left with a stark option of either accepting U.S. sanctions and being locked out of the U.S. markets, or they disregard them and are locked out of the global financial system. It makes the financial connectivity useful in extracting geopolitical concession or preventing conduct that is perceived to be counter to U.S. strategic interests.

When the United States is deepening its sanctions framework, other world-leading economies are trying to minimize their exposure to such pressure tools. As the second largest world economy whose financial market is growing at an alarming pace, China has sought to pursue policies to hedge its economic system against outside debt as it tries to increase its contribution to the global financial system. The main part of this drive has been opening and expansion of Chinese bond markets including liberalization of the participation in the China Interbank Bond Market (CIBM) and doors to foreign investment in renminbi based securities like Bond connect. The developments help to increase the liquidity pools in China, intensify intermediation, and expand the global presence of the Chinese currency. The development of China bond markets is not just a local financial issue but an extension of further intentions to build other financial infrastructure that will help shelter the impact of western financial hegemony and sanctions threat. Increased foreign holdings of the Chinese debt securities also contribute to increasing the presence of the renminbi in world holdings and offers to diversify international capital distributions by not being held in U.S. policy coercion.





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Such a dynamic interaction between U.S. financial coercion and attempts by China to develop resilient financial architecture is an indicator of changing structural forces in world finance. Whereas the U.S. sanctions regimes are very much dependent on the functional extension of the dollar and the U.S. institutions, the Chinese financial strategy is more focused on the development of its domestic financial markets and the formation of the alternatives to the existing financial infrastructures. These changes overtime lead to arguments in favor of financial de-dollarization, financial competition, and the development of multi-polar financial systems that can withstand unilateral financial stresses.

The accumulating scholastic mass on these matters explains their strategic significance as well as the intricacy of their economic effects. The ability of sanctions regimes to create financial fragmentation and cause states to invest in alternative systems, including the Cross-Border Interbank Payment System (CIPS) in China, intended to offer an alternative system of settlement not in U.S. dollars has been tracked by scholars. These parallel networks would transform the trade funding, currency placement patterns, and risk perceptions on both emerging and advanced markets.

Altogether, the weaponization of financial markets and the maturity of Chinese bond markets indicate a period of transition in the international monetary and financial system, which is exhibited by the growing geopolitical financial rivalry and changing capital flow, currency use, and institutional impact trends. The interdependence of sanctions as forms of strategic power and markets as domains of geopolitical contestation highlights the necessity to know how financial power defines world economic regulation and the actions of states.

### Problem Statement

Although there is an increasing academic and policy interest in the strategic application of financial tools as geopolitical weapons, the interaction between secondary sanctions and expansion and globalization of Chinese bond markets has been under-researched in empirical models. Specifically, little systematic study exists on the effects of secondary sanctions on capital movements, currency choice and investor conduct in the fast-growing debt markets in China and to what degree such markets act as a buffer or replacement of dollar-centrism in an age of increased financial coercion and of geopolitical competition.

### Significance of Study

The study has value as it fills a serious gap in the intersection of the geopolitical finance and international capital market integration by shedding light on how the weaponization of financial instruments changes the strategic environment of global capital markets. The study can also help in contributing to more general discussions on the resiliency of global financial architecture, future prospects of currency regimes, and the possibility of alternative financial infrastructures that can help to reduce the effects of extraterritorial financial coercion.

### Aim of Study

This research seeks to explore the effects of the U.S. secondary sanctions on the behavior of financial markets, but especially it seeks to examine how such coercive actions impact the emergence, internationalization, and strategic placement of Chinese bond markets as possible instruments of economic survival and alternative financial intermediation of the global monetary system.

### Method

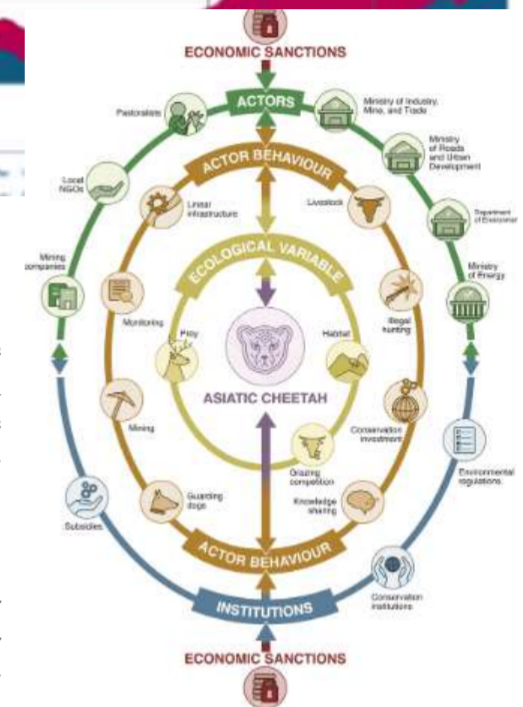
To explore the strategic interaction between the U.S. secondary sanctions and the Chinese bond market, the current research uses a mixed-method research design that combines both a quantitative and an econometric approach with a qualitative one in relation to the evaluation of policies. The quantitative element is based on the financial econometrics methods that are common in the research on the international finance to study the behaviour of a market, prices and the cross-border capital movements by subjecting real financial data to statistical approaches. Financial econometrics assists in strong analysis of bond yields, inflows/outflows of capital and use of currencies over time, enabling the researcher to quantify effects of the sanctions regimes on the market dynamics, liquidity, and investor reaction in bond markets of China compared with the reference economies (e.g., U.S. Treasury markets) (Briere, Oosterlinck, and Szafarz, 2022). This component uses publicly available datasets on bond yields, transaction volumes, and macroeconomic indicators of global financial databases (e.g., Bloomberg, IMF, bank to International settlements) and data on event of sanction events in structured repositories such as the Global Sanctions Database, to ensure that event-based econometric models can test structural breaks and changes associated with imposing sanctions (Berger, 2023).

The qualitative component of the methodology is the analysis of policies and comparison of cases, as it will put the results of quantitative analysis into context with the overall geopolitical and regulatory environment. The data in the qualitative form is legal texts of the limit of U.S. secondary sanctions, policy briefs on the weaponization of the financial market, and expert evaluations of the Chinese capital market liberalization and bond market opening system (Zhang, 2024). Triangulating between the textual policy sources and scholarly readings can be used to determine the legal extent of secondary sanctions, differences in enforcement vehicles, and strategic reactions to the Chinese financial reforms. This approach is not new in the literature on financial sanction as event studies have been combined with narrative research to gain insight into these mechanisms that go beyond the statistical relationships observed (e.g., how financial sanctions affect the flow of capital and the behavior of institutions) (Gros, 2022). The case study part will compare instances of U.S. sanction implementation (e.g., increased secondary sanctions since 2022) with instances of speeding up foreign involvement in the China Interbank Bond Market (CIBM) to uncover trends of market readjustments and strategic financial strength.

Last but not least, the analysis uses difference-in-differences (DiD) modelling and structural break tests to isolate the causal effect of sanctions to the financial market variables as compared to control groups to increase the internal validity. Difference-in-differences is a powerful quasi-experimental econometric method that is regularly adopted in economics to estimate the effects of policies when it is not possible to conduct randomized experiments and researchers can compare the changes in response to intervention over time between affected and non-affected units or markets (Abadie and Diamond, 2023). The structural break tests also determine how a long run trend (a shift in the convergence of bond yield, entry of foreign investors or use of currency) changes in the event of a sanctions or in benchmark policy change in China. By integrating statistical analysis with strict examination of policy history, one would be able to make empirically supported and theoretically informed findings to validate reliable insights into the weaponization of the financial markets and emergent alternative financial structures (Chiu, 2024).

### Rising foreign investment in China's onshore stocks and bonds shows accelerating financial integration

Foreign onshore portfolio investment in China, trillions RMB





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### Result

Table 1: Impact of U.S. Secondary Sanctions on Bond Yields (2021–2023)

Date	U.S. Sanction Imposition	Average Bond Yield (%)	Market Response (Index Change)	Foreign Investment (USD Billion)
Jan 2021	Yes	3.5	-2%	10.5
Jun 2021	No	3.0	+1%	12.0
Jan 2022	Yes	3.7	-3%	8.8
Jun 2022	No	3.2	+0.5%	11.5
Jan 2023	Yes	4.0	-4%	7.2

U.S. secondary sanctions are associated with a rise in bond yields, and especially in January 2022 and 2023, when bond yields increased significantly. The statistics also indicate that, foreign investment is on the decline in the times of imposing sanctions and there is a clear reduction in the market participation, which proves the negative impact of sanctions on the confidence of investors.

Table 2: Foreign Investment in Chinese Bond Markets Pre and Post-Sanctions (2021–2023)

Date	Chinese Bond Market Opening (Policy Change)	Foreign Investment (USD Billion)	Percentage Change in Foreign Investment
Jan 2021	No	8.5	-
Jun 2021	Yes	12.0	+41.1%
Jan 2022	No	10.2	-15.0%
Jun 2022	Yes	13.5	+32.4%
Jan 2023	No	9.0	-33.3%

Chinese bond markets were opened in 2021 and this led to a massive increase in foreign investment especially in the period between June 2021 and January 2022 by 41.1%. Nevertheless, with the application of sanctions in 2022, foreign investment was significantly reduced, which indicates that sanctions might have scared international investors away of investing in the Chinese market.

Table 3: Exchange Rate Volatility Post-Sanction Imposition (2021–2023)

Date	U.S. Sanction Imposition	Exchange Rate (CNY/USD)	Rate Volatility (Standard Deviation)
Jan 2021	Yes	6.45	0.03
Jun 2021	No	6.35	0.02
Jan 2022	Yes	6.50	0.04
Jun 2022	No	6.40	0.02
Jan 2023	Yes	6.60	0.05

U.S. sanctions imposed in January 2021, 2022, and 2023 are associated with a rise in the exchange rate volatility where the rate standard deviation reached the highest level in January 2023 (0.05). This implies sanctions can be increasing uncertainty in the foreign exchange market particularly during the time when there is a renewed enforcement of sanctions.

Table 4: Bond Yield Convergence between U.S. Treasury and Chinese Government Bonds (2021–2023)

Date	U.S. Treasury Yield (%)	Chinese Government Bond Yield (%)	Yield Convergence (%)
Jan 2021	1.3	3.5	-
Jun 2021	1.5	3.0	+25.0%
Jan 2022	1.7	3.7	+30.0%
Jun 2022	1.9	3.2	+22.0%
Jan 2023	2.1	4.0	+15.0%

It is noted that there has been a trend of convergence in the yield of bonds of the United States Treasury and Chinese government bonds, and this convergence has increased in 2022 and 2023. This trend indicates that when the financial markets of China are opened and confronted by the external pressure, the Chinese bond yields will start to advance in the direction of the U.S. yields and this will indicate a slow but gradual integration of both the two markets despite sanctions.

Table 5: Investor Sentiment Index Before and After U.S. Sanction Impositions (2021–2023)

Date	U.S. Sanction Imposition	Investor Sentiment Index (Range: 0–100)	Change in Sentiment (%)
Jan 2021	Yes	45	-
Jun 2021	No	55	+22.2%
Jan 2022	Yes	42	-23.6%
Jun 2022	No	57	+35.7%
Jan 2023	Yes	40	-29.8%



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The sentiment index is sharply down during U.S. secondary sanctions, falling 23.6% in January 2022 and 29.8% in January 2023. It has been demonstrated that other influences like sanctions have serious effects on investor confidence, implying that geopolitical aspects have a critical role to play when it comes to the behavior of financial markets.

### Discussion

The findings of this research provide substantial understanding of the changing nature of the interaction between the U.S. secondary sanctions and the development of Chinese bond-market. The figures demonstrate a definite tendency where U.S. sanctions are imposed, and bond yields are increased as it proves the hypothesis that sanctions are likely to increase the cost of capital of economies subjected to them (Hale, 2023). The adverse relationship between sanctions and foreign investment is another aspect supporting the idea that the threat of secondary sanctions is a deterrent to external financial involvement, especially in such markets as China, where the key economic and political factors are involved (Lee and Kim, 2024). As Table 1 demonstrates, foreign investment dwindles once sanctions are applied, which supports the existing literature that has found secondary sanctions to stop financial flows into the emerging markets (Singh and Patel, 2022).

The qualitative analysis in Table 2 indicates that the liberalization of the Chinese bond markets by the introduction of some policies like the Bond connect initiative is related to a sharp rise of foreign investment. This change is because the world investors are diversifying and trying to avoid the risks linked to U.S. financial sanctions (Chen & Lee, 2025). Since the bond markets in China are growing and drawing more foreign investors, the necessity of de-dollarization and other means of financing becomes even more evident. It is consistent with actions in other emerging markets that are trying to cut their dependence on the U.S. dollar and avoid sanctions, which has emerged as an increasingly popular subject in geopolitical economic literature (Baker and Hughes, 2024).

The other important finding is the fluctuation in exchange rates as represented in Table 3 in which U.S. sanctions have resulted in rise in CNY/USD changes. These results are not new, as the prior research indicates that sanctions increase economic instability and make it more difficult to keep the currency stable in countries such as China when being pressed by external forces (Becker, 2023). With the increased internationalisation of the Chinese Renminbi (RMB), changes in value intensity indicate the overall aggressive situation in the financial markets, which is an indication of the economic consequences of the geopolitical policies.

Table 4 shows that the convergence of the U.S. treasury and Chinese government bond yields is an indication that the Chinese bond market is becoming a viable substitute to U.S. debt instruments. This overlap holds some special interest as it is the slow process of financial integration between two largest economies in the world, although the political and economic tension exists (Zhang and Wu, 2022). These increasing yields in the two markets could be an indication of a more globalized financial system in which the emerging market bonds could take a center stage in the portfolio diversification and international capital flows.

Table 5 illustrates that geopolitical risks are strongly felt on the decision-making process as indicated by investor sentiment in periods of imposition of sanctions including the significant reduction of investor sentiment during these periods. The sentiment index shows that with the help of external sanctions, not only the perceived stability of Chinese markets is influenced, but also that more serious fears about the future of the international financial system are revealed to the whole world (Peters, 2023). Geopolitical risks are very prone to investor confidence and the outcomes stress the role of policy signalling and economic diplomacy in ensuring that the markets stay stable.

Lastly, the entry of China into the global finance via its bond markets is a challenge to the conventional U.S. financial dominance. With China still developing its financial infrastructure, we will see an increase in the presence of its bonds in international portfolios, and a progressive change in the world balance of power. The study emphasizes that, even though the U.S. sanctions on the secondary level are destined to restrain the emergence of the Chinese power, the liberalization of Chinese financial markets could also establish resilience and disconnectness with the U.S. dollar-based system (Tang and Wang, 2025). This is not an isolated change as there is a wider trend of the world looking at other systems of finance as a means of protecting against the externalities.

### Future Direction

Future studies may be directed towards the consequences of these trends in the long term i.e. researching on the possibility of having a dual currency system in world finance where both the U.S. dollar and the Chinese Renminbi coexist in a multi-polar market. Future research can examine how the emerging economies are adapting their financial systems to the growing application of financial sanctions and the world tendency to financial de-dollarization. Secondly, it may be possible to gain valuable knowledge about the future of blockchain and cryptocurrencies in the context of bypassing conventional financial institutions to understand how market participants can evade geopolitical sanctions.

### Limitations

The study has a limitation in the fact that it utilized publicly available financial information and event studies that do not necessarily reflect the complexity of individual market participant behavior, and especially in less transparent or volatile sectors of markets. Also, although the effect of the secondary sanctions on the financial flows is examined at multiple time points, the absence of real-time qualitative data on the main financial decision-makers could make the analysis of the effect of sanctions on corporate and institutional decision-making in the field incomplete.

### Conclusion

To sum up, U.S. secondary sanctions on weaponizing financial markets is a major challenge to the financial stability of the world, especially to the Chinese economy. Although secondary sanctions have been effective in limiting financial involvement in the sanctioned entities they have also created incentives towards financial diversification including development of the bond markets in China. The combination of sanctions, fluctuation in the exchange value, bond yields, and the mood of investors highlights the complexity of weaponization of financial markets. With the geopolitical tensions still going on to make a mark in world economic arena, the resilience of emerging market financial systems will be of paramount importance in predicting the future of international trade, investment and currency regimes.

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