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# China Edges Closer to IMF Seal of Approval With Yuan Policy Move

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The yuan's surprise devaluation roiled global markets and drew scorn from Donald Trump. Still, China's new market-driven exchange rate bolstered its bid to join the world's most elite currency club.

As the yuan's fall broke a rally in the Standard & Poor's 500 Index and prompted a commodities selloff, some U.S. politicians were quick to label China a currency manipulator and raise fears of a new foreign-exchange war. China indicated the Aug. 11 move gave market forces greater say as it tries to sway an International Monetary Fund review to include the yuan alongside the dollar and euro as a global reserve currency.

The shift to the more flexible exchange rate should boost the nation's case for the yuan to be included in the IMF's so-called Special Drawing Rights, said Eswar Prasad, a trade policy professor at Cornell University who previously headed the IMF's China division. The move is "consistent with other signals that China is making slow but steady progress toward market-oriented reforms, such as capital-account opening, exchange-rate flexibility and interest-rate liberalization," he said.

Coming in the wake of a \$4 trillion stock rout and days after a dismal report on Chinese exports, the reserve-currency argument was drowned out in the confusion over the devaluation that led to the biggest weekly loss in Asian currencies in four years. The move also creates potential headaches for U.S. President Barack Obama as he prepares to host Chinese President Xi Jinping at a summit in September.

## Congress Objections

"China has done what the Treasury has repeatedly asked for," said Nicholas Lardy, a senior fellow at the Peterson Institute for International Economics in Washington and author of "Markets Over Mao: The Rise of Private Business in China." "If a few members of Congress object, that is a problem for the executive branch, not China. It should bolster their chances, it is what the fund asked for. I think the angst about the new system will be alleviated over the coming weeks."

Trump, who is leading in opinion polls to become the Republican nominee for president, injected the issue into the 2016 campaign, saying Aug. 11 that “‘devalued’ means ‘sucks the blood out of the United States.’” Charles Schumer of New York -- the third-ranking Senate Democrat -- has threatened legislation to punish China with import tariffs.

The IMF and the U.S. Treasury have been pushing China to loosen the rigid exchange-rate mechanism that restricts the yuan’s moves. The Washington-based fund only conducts its SDR review every five years and that may have accelerated China’s efforts to get the yuan included in the group of currencies held as reserves by the world’s central banks that currently includes the U.S. dollar, euro, yen and British pound.

The People’s Bank of China said on Aug. 11 that price submissions for the yuan’s daily reference rate must now consider the prior day’s close, foreign-exchange demand and changes in major currency rates. The IMF, which rejected the yuan in 2010 on the grounds that it wasn’t “freely usable,” called China’s move a “welcome step,” while cautioning the change had no direct effect on the SDR review.

## Breakneck Growth

China has been seeking reserve status as part of a campaign to play a larger role in the postwar global economic order designed and dominated by the U.S. Membership of the reserve-currency club would be a crowning achievement after three decades of breakneck growth that saw the Chinese economy take its place as the world’s second-largest after the U.S.

The devaluation may ensure there’s enough time for the emotions to ebb before the Xi-Obama summit, said Arthur Kroeber, Beijing-based managing director at GaveKal Dragonomics, an independent global economic research firm.

“There is no good time to do these things; moreover, it seems clear in retrospect the PBOC did not anticipate the very negative market reaction,” he said. “Waiting until after the summit would have been far too late to build credibility with the IMF.”

## IMF Chances

Standard Chartered Plc in Hong Kong revised its forecast for the yuan’s SDR chances to 80 percent by the middle of next year from 60 percent by the end of this year, said Ding Shuang, the bank’s chief China economist.

“The timing chosen was actually fine,” said Ding, who spent a decade at the IMF in Washington as its

senior economist on cross-country economic research. “You need to allow ample time to run the new mechanism before review, and leave enough time gap to facilitate its assessment.”

To qualify for the basket, the country must be a major exporter, and the currency must be “freely usable.” IMF staff said this month the yuan trails its counterparts on key benchmarks and “significant work” remains to show it qualifies as a reserve currency. The IMF on Wednesday delayed any decision on changing the basket for nine months, until September 2016, a move staff had proposed to minimize disruption if the yuan was added.

## Political Element

The IMF executive board, which represents the fund’s 188 member nations, must approve any change to the currency basket, a requirement that adds a political layer to the technical analysis done by staff. The U.S. has 17 percent of votes in the IMF’s executive board.

China’s system of maintaining trading bands to limit the yuan’s fluctuations means the yuan can’t be deemed as freely usable, said Fraser Howie, director at Newedge Singapore and co-author of “Red Capitalism.” The onshore spot rate in Shanghai is currently limited to moves of 2 percent on either side of a daily fixing set by the PBOC.

“You cannot control your currency for 10 years and take a few actions over the space of a week, and say, ‘Look, we are now a freely usable currency,’” he said. “You need to go through some cycles, and get at least months, if not years of data to show China is allowing its currency to fluctuate through economic cycles.”