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IMF signals doubts on renminbi as reserve currency

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The International Monetary Fund has hailed China's progress on financial reform but said the renminbi still lags behind rivals on key metrics that determine whether the fund will formally endorse the redback as a reserve currency.

The fund's executive board will make a final decision on the renminbi late this year as part of its regular five-yearly review of the currency composition of its special drawing rights, a global reserve asset comprising the dollar, euro, pound and yen.

China's leadership has been pushing for the addition of the renminbi, which would serve as recognition of the currency's rising global status and a signal to the world's central banks that renminbi assets are a solid investment. Christine Lagarde, IMF managing director, has said the renminbi's inclusion is a "matter of when, not if".

A judgment about whether the renminbi is "freely usable" is crucial to the IMF's final decision. As part of the review process, the board recently held an "informal meeting" to discuss the staff report.

"Across a range of indicators, the renminbi is now exhibiting a significant degree of international use and trading. At the same time, the four freely usable currencies (already in the SDR) generally rank ahead of the renminbi," the IMF staff said in the report.

"The report signals that the decision about the renminbi's inclusion in the basket hinges on financial market development, further opening of the capital account, and greater exchange rate flexibility," said Eswar Prasad, former IMF country head for China.

In particular, the report calls on China to increase foreign access to its onshore stock and bond markets, especially government bonds. It does not reference China's recent interventions to support its volatile stock market. Ms Lagarde recently said these actions shouldn't influence the fund's SDR review.

European powers such as Germany, France and the UK have expressed support for adding the renminbi this year, but the US, which holds the largest voting share of any member, has expressed reservations.

Jacob Lew, US Treasury secretary, in late March urged more progress in deregulation of Chinese cross-border investment flows and domestic interest rates before an IMF endorsement of the renminbi.

The staff report appears to pave the way for a compromise by proposing to extend the current SDR basket only until September 2016, rather than the next mandatory review in 2020. But the IMF noted that its proposal "does not prejudge the timing and outcome of the review".

"We still think it is highly likely that renminbi will be included — though for technical reasons, the actual date of inclusion may be extended to September 30, 2016, to give reserve managers time to adjust," Wang Tao, chief China economist for UBS, wrote.

But to others, the proposal still has the whiff of political compromise. Mr Prasad noted that the extension would "open the door for a positive decision on the renminbi's inclusion in the SDR basket if the Chinese government makes a firm commitment to undertake reforms and policy actions needed to enhance the currency's free usability over the next year".

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