FINANCIAL TIMES

September 28, 2015 6:53 am

China’s renminbi creeps closer to global reserve status

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The International Monetary Fund is creeping closer to including China’s renminbi in an elite basket of reserve currencies, with the US and other major shareholders likely to back the move unless IMF staff make a surprise recommendation against inclusion.

But remaining technical hurdles, concerns over Beijing’s heavy-handed intervention in markets and poor communication of reforms such as the changes to its foreign exchange regime that set off a bout of turmoil in global financial markets last month, are causing nervousness within the IMF.

The caution has prompted some IMF staff to raise the possibility that a vote by the fund’s board due to take place in November could be delayed into early next year to give China more time to deliver reforms and build credibility at a time when many outside observers have grown sceptical.

A move to include the renminbi in the basket used to value the IMF's de-facto currency, the Special Drawing Rights, would represent its biggest shake-up since the creation of the euro, which together with the dollar, yen and British pound now makes up the elite club. For that reason the IMF in August announced that it would delay the technical rollout of the new SDR basket until September 30 next year to give central banks around the world plenty of time to prepare for any change.

However, a move to delay the actual decision over whether to include the renminbi even for a few months beyond this year would raise questions about whether the IMF was according China special treatment. The SDR basket is subjected to a review every five years and IMF officials have repeatedly said they are committed to concluding the current iteration by the end of this year.

While the case for inclusion was in theory bolstered by the shift to give the market a greater say in the daily band in which the renminbi is permitted to trade, the reaction has caused delays in other reforms.

"The IMF and the Chinese government had anticipated that more of the [needed reform] boxes would have been ticked by this time," says Eswar Prasad, a former head of the IMF's China operations who now teaches at Cornell University in the US. "But things have fallen a bit behind partly because of the Chinese government's mismanagement of its liberalisation move . . . And that has come back to haunt them and the IMF."

Chinese officials have been expressing confidence about their bid and since August have been trying to reassure other capitals that their commitment to reform is genuine.

In Washington last week Xi Jinping, the Chinese president, sought to assuage concerns among some in the US about the impact of a weaker renminbi and stronger dollar on American competitiveness, declaring that "there is no basis for the renminbi to have a devaluation in the long run". He also thanked the US for its conditional support for Beijing's bid to have the currency included in the SDR basket.

"China has made real and permanent progress that will not just be gone with the wind," Jin Zhongxia, Beijing's representative to the IMF, told a forum earlier this month.

The IMF has two main criteria for measuring whether to include a currency in the SDR basket: the country's role as a major trading economy and whether its currency is "freely usable".

China, which is now the world's largest trading nation, long ago met the first test. But whether it meets the second, freely usable, test is still up in the air. The big question for the IMF is not China's capital controls but whether, in practical terms, member countries in crisis would be able to use the renminbi if needed.

Beijing has helped its case by opening up part of its domestic bond market to other central banks in recent months and by liberalising the way interest rates on deposit products are set. But further reforms are still expected by the IMF.

The fund is also working with member central banks to test things such as whether there is sufficient liquidity in the renminbi in all global time zones to handle orders worth tens of millions of dollars to sell or buy the currency without shifting the markets significantly.

Even as that technical work happens, however, the political battle over the RMB's inclusion appears to have been largely won.

Changing the SDR basket requires the support of 70 per cent of IMF shareholders, meaning the US, which holds 16.7 per cent of voting shares, does not have its usual veto.

But US officials, burnt by their unsuccessful bid to lobby European and other allies not to be founding members of the Chinese-led Asian Infrastructure Investment Bank, say they are determined to keep their decision a purely "technocratic" one. Moreover, countries such as France have come out with less conditional support for the Chinese bid in recent weeks.

"The Chinese have made up their mind to be part of this," says Meg Lundsager, who until last year was the US representative on the IMF's executive board. "At this point it just seems very hard to oppose. What would be the grounds for opposing? To resist this you would have to have really strong grounds that on some of the metrics the Chinese just aren't there."

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