THE GLOBE AND MAIL

November 17, 2009

# Calls rise for new global currency

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Globe and Mail Update

*As U.S., China spar over yuan valuation, IMF chief sees basket of currencies replacing dollar as benchmark*

Tensions over two of the world's major currencies are escalating, playing out in economic and political circles as countries make a desperate push for crucial trade dollars.

Visiting China, President Barack Obama said he wants the country to dismantle its currency peg to the U.S. dollar. But while the two countries bicker over the value of the yuan, momentum is building for a replacement for the world's reserve currency.

But International Monetary Fund director Dominique Strauss-Kahn says the days of one country's currency as the global benchmark are numbered. The U.S. dollar remains the currency standard, but globalization demands a new global currency that provides representation for the growing importance of a variety of major economies, Mr. Strauss-Kahn said during a trip to China.

Increasing talk for a new global currency comes as friction mounts between the United States and China over the yuan, whose restrained value helps keep China's exports competitively priced. During his visit to China, President Obama on Tuesday urged China to expose the yuan to market-oriented forces and let it rise.

But aside from fending off pressure to let its currency climb, China has a bigger problem. Its fortunes are inexorably hitched to a faltering U.S. dollar and all the economic challenges that entails, including exploding deficits, lurking inflation and a gusher of easy money that may be hard to cap.

Every time the dollar dips, so too does the value of China's massive and growing foreign exchange reserves - 70 per cent of which, or an estimated $1.6-trillion, are stashed away in various U.S. dollar investments.

It's the classic trap. China's not happy living with the dollar, but it can't live without it.

China's reserves are so large that diversifying out of the dollar and into the euro, or any other currency, isn't feasible because those other markets aren't big enough or deep enough to accommodate its cash. And even a hint that China was poised to dump dollars would send the greenback spiralling further downward, deepening losses on the country's offshore holdings.

The result is that the U.S. and China are caught in "a dangerous game of chicken that could easily spin out of control," argued Eswar Prasad, a senior fellow at the Washington-based Brookings Institution and a former top IMF official. "A precipitous action by China to shift out of U.S. dollar instruments, or even an announcement of such an intention, could act as a trigger that nervous market sentiments coalesce around, leading to a plunge in bond prices and the value of the U.S. dollar," Mr. Presad pointed out.

Facing deficits totalling $9-trillion over the next decade, the United States desperately needs China's cash to finance its profligate ways.

None of China's possible escape routes offer much short-term relief. Speaking at a forum in Beijing Tuesday, the IMF's Mr. Strauss-Kahn said the global financial system would be a lot better off if countries embraced the concept of a truly global currency, possibly based on the fund's own accounting unit, the special drawing right or SDR. "That probably has to be a basket," he said of the eventual replacement for the dollar. "In a globalized world there is no domestic solution."

Chinese central bank governor Zhou Xiaochuan embraces the idea of morphing the SDR into a new super currency.

But most experts say that's a decade or more away.

"If it does happen, it will take an extended period of time," said Benjamin Reitzes, an economist BMO Nesbitt Burns in Toronto. "It won't be all of a sudden."

And if it does happen, the U.S. dollar will still be significant part of the mix, perhaps 50 per cent of any basket, Mr. Reitzes said. "It's not as if they're eliminating the U.S. dollar altogether and we're just going to use the euro instead," he said.

Even Mr. Strauss-Kahn acknowledged that in the short-term, China should let its yuan strengthen to help smooth out imbalances in the global economy and boost domestic demand. That, in turn, would depress the value of its foreign reserves.

And so for now, China has little choice but to hitch a ride on the Greenback Express, wherever it may go.

"They're going to keep accumulating dollars. That's just the reality," agreed Charles Freeman, a former assistant U.S. Trade Representative for China, who now holds the China chair at the Center for Strategic and International Studies in Washington.

Indeed, China and other countries boosted their holdings of Treasury bills and other U.S. financial assets in September, the U.S. Treasury Department reported yesterday. China, the largest foreign holder of Treasuries, increased its holdings by $1.8-billion to $798.9-billion.

The Chinese are buying more of a currency in which they have increasingly less faith because they don't have a choice, BMO Nesbitt Burns' Mr. Reitzes said.

"There really is nowhere else to go," he said. "It's kind of the U.S. dollar by default at this point," he said.

The SDR isn't yet anything more than an internal IMF exchange unit, the euro has its capacity constraints and the yen's influence is on the wane, along with Japan's relative economic clout.

Ultimately, Mr. Reitzes said the yuan has the best potential to become an alternative to the U.S. dollar as a reserve-like currency. But that means China will have to end its peg to the U.S. dollar and let the yuan float.

"The yuan is the only currency I can see that would challenge the U.S. dollar, but that could be 25 or 30 years away," Mr. Reitzes said.