Renminbi

China's renminbi joins elite global reserve currency club

Currency's entry into IMF basket a milestone in long march to international acceptance

© AP

SEPTEMBER 30, 2016 by: **Tom Mitchell** in Beijing

China's renminbi formally becomes a reserve currency on Saturday, the 67th anniversary of Communist party rule (http://next.ft.com/content/63a5a9b2-85cd-11e6-8897-2359a58ac7a5) in China, reaching a milestone on its long march to international acceptance.

Government officials led by Zhou Xiaochuan, head of the People's Bank of China, lobbied long and hard for the renminbi to be included in the International Monetary Fund's special drawing rights — a reserve asset whose value was previously determined by a basket of just the dollar, euro, yen and pound.

Mr Zhou's determination that the renminbi join this elite group reflects a dual agenda — reducing the global dominance of the US dollar while also overcoming domestic opposition to currency reforms at home.

While US economic output has declined from 22 per cent of the global total in 1990 to an expected 15 per cent by 2020, the greenback has retained its dominant position and "haven" status even in the wake of the global financial crisis. About 90 per cent of all currency trades involve the dollar, compared with 40 per cent for the euro and just 2 per cent for the renminbi (http://next.ft.com/content/3a7b4eea-b4f2-11e5-8358-9a82b43f6b2f).

According to Chinese policymakers and their advisers, Mr Zhou used the prize of SDR inclusion to overcome resistance to controversial reforms aimed at making the renminbi's own value more market-determined.

"China is likely to push for a more prominent role for the SDR in global finance as a means to elevate its own currency's prominence," says Eswar Prasad, a professor at Cornell University and author of a forthcoming book on the renminbi.

Beijing was one of the leading proponents of the World Bank's debut issue of SDR-denominated bonds (http://next.ft.com/content/a9175aee-603f-11e6-ae3f-77baadeb1c93) on the eve of September's G20 summit in Hangzhou, while Chinese policy banks are reportedly considering SDR bond issues of their own.

Both developments were foreshadowed by a policy paper (http://www.bis.org/review/r090402c.pdf) issued by Mr Zhou during the depths of the global financial crisis. Published in March 2009, the paper argued that "the crisis and its spillover to the entire world reflect the inherent vulnerabilities and systemic risks in the existing international monetary system".

"Giving the SDR a more central role in global finance would allow the IMF to act as a global lender of last resort, reducing the reliance of the international monetary system on any single national currency or central bank," adds Prof Prasad, a former head of the IMF's China division.

Mr Zhou almost stumbled at the final hurdle of his long campaign. In August 2015 he failed to communicate clearly a technical change aimed at giving the market a greater say in determining the renminbi's "daily fix" against the dollar, spooking international investors.

That was followed by an even worse outbreak of turbulence (http://next.ft.com/content/4cde4cc4-b847-11e5-b151-8e15c9a029fb) on China's equity and currency markets in January, as the PBoC sought to emphasise the renminbi's performance against a basket of international currencies rather than just the dollar.

After rising almost 30 per cent in the 10 years to January 2014, when $1 bought just six renminbi, the redback has since retreated more than 10 per cent to Rmb6.67 to the dollar. Donald Trump alluded to this recent decline in Monday's presidential debate against Hillary Clinton, in which he highlighted China's alleged "manipulation" of the renminbi.

Related article

The return of Mao: a new threat to China's politics (http://next.ft.com/content/63a5a9b2-85cd-11e6-8897-2359a58ac7a5)

The dictator is enjoying a surge of popularity amid an age of growing inequality. But the rise of a neo-Maoist movement threatens the stability of China's political system

But Chen Long, China economist at Gavekal Dragonomics, notes that for most investors — and even the US government (http://next.ft.com/content/dd5c1292-2870-11e6-8ba3-cdd781d02d89) — the PBoC's "gradual and managed depreciation of the renminbi is a non-story right now".

Christine Lagarde, IMF managing director, said the inclusion of the renminbi in the SDR basked was a recognition of the progress China had made in reforming its monetary, foreign exchange and financial systems as well as advances liberalising its financial markets.

"The extension of the SDR basket is a historical milestone for the SDR, for the fund but more importantly for China and the international monetary system," she said. "It is an important step in the integration of the Chinese economy into the global financial and monetary system."

The Chinese economy's better than expected performance over recent quarters and the UK's decision to leave the EU have deflected international attention from the PBoC's earlier policy errors, allowing for a smooth run-up to this weekend's official inclusion in the SDR.

The only better present Mr Zhou could hope for is an electoral triumph next month for Mr Trump. The Republican nominee has said that international investors might be willing to accept a haircut (http://next.ft.com/content/ae30974c-13a6-11e6-

bb40-c30e3bfcf63b) on their US government debt, a move that could hasten the reordering of the global currency order that Beijing has long sought.

Additional reporting by Shawn Donnan