THE WALL STREET JOURNAL.



http://www.wsj.com/articles/china-marks-milestone-with-yuans-entry-into-imf-reserve-basket-1475260422

WORLD | ASIA | CHINA NEWS

# China Marks Milestone With Yuan's Entry Into IMF Reserve Basket

Move confers a measure of legitimacy after Beijiing's yearslong effort to internationalize its currency; remains far from countering dollar's status

The yuan will be used as one of the International Monetary Fund's official lending reserves, joining the dollar, the euro, the yen and the pound. *PHOTO: KIM KYUNG HOON/REUTERS*

By **IAN TALLEY** in Washington and **LINGLING WEI** in Beijing
Sept. 30, 2016 2:33 p.m. ET

China's yuan officially enters the International Monetary Fund's basket of reserve currencies Saturday, a telling trophy in the transformation of the Asian giant's geopolitical status.

Along with the dollar, the euro, the yen and the pound, the yuan will now be used as one of the IMF's official lending currencies in emergency bailouts. The fund's stamp of approval confers a measure of legitimacy on the yuan after a yearslong effort by Beijing to internationalize its currency.

The move shows how China's financial diplomacy has evolved from heavy-handed aid to governments in decades past to a multipronged strategy to challenge the U.S.'s global economic dominance.

Still, many experts say Beijing remains far from truly countering Washington's clout because of the very limits China puts on its own markets.

RELATED

- Yuan's Appeal Wanes as It Joins IMF's Reserve-Currencies Club

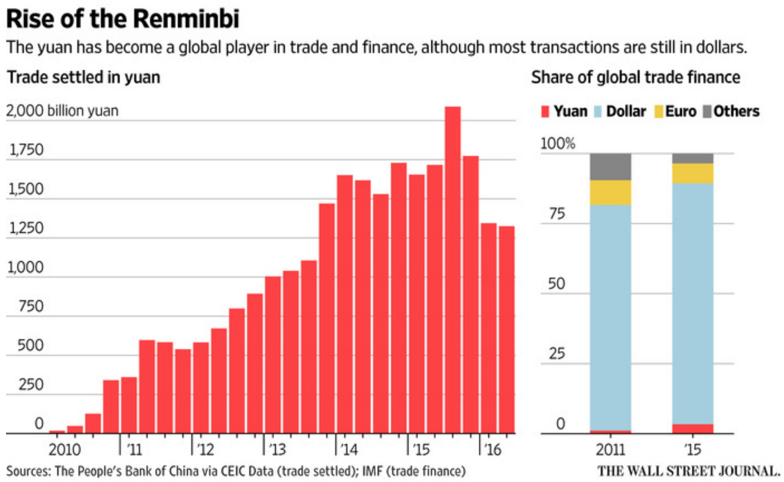
The inclusion of the yuan in the IMF's lending reserves is more a symbolic victory than a market-shaping event. Central banks have only marginally increased their stocks of China's yuan since the IMF last year announced its decision.

While some economists question the yuan's inclusion—given Beijing's tight controls over the exchange rate and cross-border capital movements—the IMF said it was a justifiable acknowledgment of the country's development into a global economic powerhouse.

"It's an irreversible path towards opening up, integrating into the global economy and playing the economic game by the rules," said IMF Managing Director Christine Lagarde.

For Beijing, the inclusion in the IMF basket is a measure of its growing global clout, part of a broader plan to leverage its newfound power as the world's second-largest economy.

The Communist government is beefing up its military, testing the physical limits of its borders, accelerating its space exploration program, and trying to compete with Hollywood in the global movie industry. And Chinese companies, many of them state-owned, are buying up assets and investing around the world at an unprecedented rate. According to the Rhodium Group, China's investments and acquisitions in the U.S. alone have ballooned from $3 billion 10 years ago to $81 billion in 2016.




"Back in early 2000s, China's approach was basically to funnel money into African countries, and they got a lot of pushback," said Eswar Prasad, a Cornell University economist and former top China hand at the IMF. "Since then, it has become much more savvy in its engagement in the international financial community."

Official reserve-currency status caps years of efforts to meet the IMF's criteria. Over the past five years, Beijing has managed to turn a trickle of yuan-denominated transactions into a flood: A third of its total cross-border trade is now in the yuan.

It established banking relationships in major capitals around the world to facilitate trade settlement, including one in New York City earlier this month, the first in the U.S. It set up nearly three dozen standing bilateral credit lines to help cover trade transactions and any potential cash shortages.

Yuan internationalization was only one aspect of its broader diplomatic strategy, though. Over the past decade, China has transformed from a net borrower of development assistance to a net lender. Beijing has secured a foothold in nearly every major international financial institution, including installing senior executives at the IMF and the World Bank.

It has also set up a host of alternative financing institutions, including the $240 billion Chiang Mai Initiative, the $100 billion Contingency Reserve Arrangement, the $100 billion New Development Bank and the $100 billion Asian Infrastructure Investment Bank, or AIIB.

Just as the reserve-currency status marks a milestone in China's economic development, many analysts point to the launch of the AIIB as a key marker of China's growing sophistication as a financial diplomat.

Washington was dealt a major diplomatic embarrassment last year after failing to prevent its key allies around the world from joining Beijing's new infrastructure bank. Outmaneuvered by Beijing, the administration was later forced to call a truce, saying instead it would cooperate with the institution through its World Bank lending.

And Beijing is countering a move by Washington to bolster its relationships with the countries encircling China through the Trans-Pacific Partnership trade pact. Its "One Belt, One Road" development and trade project is intended to craft a new Asian order with Beijing at the center, at an estimated cost of $1 trillion.

"Putting this in perspective, the U.S. Marshall Plan to finance Europe's recovery after World War II cost something just over $100 billion in today's dollars," says John Copper, author of a three-volume book on Beijing's foreign aid and investment diplomacy.

Although in flexing its newfound might China is challenging traditional U.S. financial strongholds, it isn't likely to break Washington's economic domination soon. There is a reason why most of the world's transactions and currency reserves are held in dollars: It is considered the safest and most secure economy in the world.

In contrast, while the yuan is now an international reserve currency, it isn't a "safe haven" currency.

China isn't engendering the trust of foreign investors, Mr. Prasad said, because it doesn't have strong financial institutions like an independent central bank, trusted rule of law, and an open and transparent form of government with checks and balances.

"China has made abundantly clear it's not going to have any of these," he said, adding that will limit likely limit global reserve holdings of yuan to 5% to 15%.

Comparing the yuan with other elite currencies shows the challenges that still lie ahead, including for China's economic diplomacy more broadly. China's currency is used in only 1.86% of the world's total payments—compared with 42.5% in the dollar, 30% in the euro and 7.5% in the pound. While the stock of central-bank reserves held in the yuan have nearly doubled in the past several years, it is still between 1% and 2% of total assets.

And private demand for the yuan has soured as the country's growth slows faster than expected. Yuan deposits in Hong Kong, the biggest offshore clearing center, have fallen from 1 trillion in July last year to 0.7 trillion in July this year.

"In the long run, China will eventually liberalize its capital account to a larger degree," said Jin Zhongxia, Beijing's top representative to the IMF and a former senior People's Bank of China official. The exchange rate will also become much more flexible, Mr. Jin said.

"But that will not happen in one step," he said. "It will go through a gradual, or evolutionary, process."

*—Gregor Stuart Hunter and Saumya Vaishampayan in Hong Kong contributed to this article.*

**Write to** Lingling Wei at lingling.wei@wsj.com