

European debt rescue could pave way for renminbi borrowing

By David Marsh in Beijing

In the wake of last week's new deal on European debt, China is serving up a steely reminder to Europe: you may have to start borrowing in renminbi to gain a sympathetic hearing from the world's largest creditor.

Already officially enshrined as bankers to the world's biggest debtor, the US, the Chinese have no wish to become, too, a last-ditch lender to the Europeans. The idea of renminbi borrowing has been put forward by Beijing advisers and officials as a way of lowering Chinese foreign exchange risks caused by further exposure to Europe - and also of using the Europeans' latest discomfiture to advance China's international monetary policy agenda.

If European borrowing in the Chinese currency became a reality, it might pave the way for the US Treasury eventually to issue renminbi-denominated paper – a momentous milestone in world monetary history.

Klaus Regling, the head of Europe's EFSF rescue fund, was in Beijing at the end of last week to explain the latest bail-out efforts. Significantly, Regling did not rule out renminbi funding in future.

The Chinese have shown impatience with Europe's stop-start approach to solving the debt crisis. Like other large investors throughout Asia, they are surprised that travelling Europeans expect them to buy bonds from hard-pressed European governments when the institution they have expected to be the lender of last resort, the European Central Bank, balks (for whatever reason) at intervening to stem the rise in Italian bond yields.

In a telephone call on Thursday to discuss this week's G20 summit in Cannes, President Nicolas Sarkozy explained the latest bail-out measures to President Hu Jintao. The Chinese leader told him he hoped the measures would 'help Europe stabilize financial markets'. The state Xinhua news agency was lukewarm, saying, 'While China and other emerging countries indicated they won't be bystanders of the eurozone crisis, it would be unfair to ask them to shoulder the same responsibility as those directly responsible for the crisis. Emerging economies should not be seen as the EU's Good Samaritans – in the end, the EU has to pull itself out of the crisis.'

Chinese officials say that, rather than considering further bilateral lending to Europe through the byzantine assortment of additional EFSF instruments, China is far more likely to agree to funding Europe via additional multilateral agreements with the International Monetary Fund. These would provide the Chinese with more leverage over conditionality, expose them to fewer risks and also allow the emerging market economies as a bloc to lay down the law more effectively with regard to the western nations that still dominate the Fund.

Chinese observers make the point that the Beijing government is under much more pressure than ever before from an alert internet-savvy public to resist cash appeals from errant European governments when millions of ordinary Chinese are still struggling with worrisome social, economic and environmental conditions and, in some cases, abject poverty. So renminbi borrowing – even though it could expose Europe to problems if the Chinese currency rises – could provide an appropriate compromise acceptable to both sides.

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