Chinese SDR inclusion could trigger global assets shift

Further renminbi appreciation would complicate Beijing's efforts on slowdown

by David Marsh

Tue 26 May 2015

A large shift of global institutional assets into renminbi could take place if the International Monetary Fund concludes later this year that the Chinese currency should join the Special Drawing Rights, the Fund's composite currency unit used in official worldwide transactions Some sizeable moves on world capital markets could take place pre-emptively if opinion hardens in the next few months that the IMF is about to bring the renminbi into the SDR, combining the world's most important reserve currencies. This could spur further appreciation of the renminbi that could represent another depressant for the Chinese economy, complicating Beijing's efforts to prevent an unduly sharp slowdown this year. A possible conflict between China's international monetary ambitions, on the one hand, and, on the other, the need to keep the economy on an even keel was highlighted in a seminar on the SDR and the renminbi organised in Beijing on 22 May by the International Monetary Institute of Renmin University and central bank research group OMFIF. Whether the SDR could or should be expanded from its present four constituents, the dollar, euro, yen and sterling, is being debated at a technical level, ahead of a decision by the IMF executive board before the end of the year. An intriguing issue is whether this becomes elevated to a political question between the US and Chinese governments. A decision to include the renminbi in what is effectively an association of the world's top reserve currencies has big implications for financial markets, to which only a few specialists hitherto have paid much attention. The general consensus at the Beijing seminar was that, from a technical point of view, the renminbi was probably well on the way to SDR membership. Although many Chinese financial market participants believe the US opposes renminbi inclusion, Washington cannot – even if it wished to – by itself block adhesion. The SDR decision requires a 70% majority on the IMF executive board. The US has the power to veto solely decisions that require an 85% majority. In addition, the US will almost certainly not wish to risk another potentially embarrassing showdown with China just months after being rebuffed in its attempt to block western countries' adherence to the China-led Asian Infrastructure Investment Bank. China is keeping the door open to possible US participation with a 10% stake in the AIIB – even though Congress in its present mood would probably block the administration from signing up if it showed willingness to do so. The issue of whether the Chinese currency could join the SDR is a much more technical issue than the AIIB, without an impact on the US budget, and would not require Congressional approval. However a positive decision would allow China effectively to leap ahead to become the world's fifth most important reserve currency, compared with its present position as No. 7, behind the present four SDR members as well as the Australian and Canadian dollars, which the IMF also regards as reserve currencies. On a rough calculation, there may be around $100bn of renminbi reserves in central bank holdings, about half the total of Canadian and Australian dollars (around $200bn each). On this basis, an SDR inclusion decision could spark a further $100bn worth of renminbi purchases by central banks to bring renminbi holdings up to the same levels as for the Australian and Canadian units. To bring renminbi holdings up to the same level as those in sterling and the yen, central banks would need to purchase roughly $300bn of renminbi in different assets. A possible shortage in coming years of renminbi-denominated assets suitable for central banks' and other large investors' holdings was one of the themes of last week's Beijing discussions. These potential asset moves are not highly significant compared with overall worldwide assets in the fund management industry of around $80tn, OMFIF's estimate of global official sector assets of $30tn, and daily foreign exchange turnover estimated by the BIS at $5.3tn. However, official asset shifts of this nature would be a milestone event, especially if accompanied by similar private sector movements. These are all developments for which the global financial industry should be prepared.