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China comes in from the cold

Beijing indicates leaning to sterling

by By David Marsh in New York

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Little by little, China's reserve managers are coming in from the cold. Beyond the hue and cry of the summer renminbi currency adjustment, one issue is clear. Beijing is accelerating efforts to improve transparency of its international reserve data, part of a bid to enter the special drawing right, the composite currency unit of the International Monetary Fund.

China has started to supply information to the IMF on the currency make-up of its foreign exchange reserves. This is a momentous change for a country that has habitually believed that lifting the veil on its currency holdings is tantamount to revealing secrets about its nuclear weapons arsenal.

The methodology China has chosen is simple, and has been discussed informally for several years. The People's Bank of China is filtering through to the IMF a gradual breakdown of components of its holdings on a piecemeal basis, so that outsiders cannot deduce accurately the constituents of China's $3.6tn of foreign exchange. Based on data last week, an informed 'guestimate' would say that China has more sterling in its reserves than the previously reported world average of 3.9%, while it may have been lightening up on its holdings of euros during the early summer. We have known for several years, as a result of comments from Chinese officials as well as partial accounts in obscure state publications, that China has been diversifying reserves, with a number of Asian currencies in its holdings and a proportion of dollars close to the international average of 64%.

Last week's quarterly data under the IMF's 'currency composition of official foreign exchange reserves' (Cofer), breaking down world reserve holdings as of 30 June, show an increase in 'allocated reserves' (on which the IMF has data) of around $600bn compared with the previous quarter.

Beijing is seeking to win international endorsement of the renminbi in the basket of reserve currencies making up the SDR, in a move that could be decided in November and enacted in 12 months. As part of improved transparency, China has started to give more up-to-date details of its gold reserves and has acquiesced in IMF efforts to start collating stocks of renminbi in other countries' holdings. According to partial data revealed in August, 38 reserve-owners around the world hold $70bn in renminbi, making up 1.1% of overall official assets. It is presumably only a matter of time before the IMF includes renminbi holdings in full Cofer data.

In a note on the Cofer release, the IMF said China has reported a 'representative portfolio on a partial basis.' China will gradually report its full holdings over two to three years. The IMF broke new ground by listing all the countries reporting foreign exchange holdings. In Cofer the IMF counts 146 reporting entities including some 'non-member countries/economies' (compared with Fund membership of 188 countries) as well as 'other foreign exchange reserve holding entities'. Only 96 of these 'reporters' agreed to have their names released.

Large reserve owners such as India and Saudi Araba are still believed to be resisting giving the Fund details of their foreign exchange holdings, but the China move may make it more difficult for such 'hold-outs' to persist.

Total world foreign exchange reserves in the second quarter rose slightly to $11.46tn from $11.44tn, while allocated reserves rose to $6.67tn from $6.06tn.

One reason for China's propensity to diversify reserves has been the widespread feeling (not just in the US but in China too) that Beijing and Washington have entered into a dangerous co-dependence as a result of the build-up of dollar reserves. This is one reason for China's enthusiastic espousal of the euro in the past 15 years as well as its more recent eagerness to acquire sterling, now formally ensconced, on the latest IMF figures, as the world's No 3 reserve currency after the dollar and the euro.

The euro's share of allocated reserves fell to a 13-year low of 20.5% in the second quarter from 20.8% in the first quarter, despite valuation effects that would otherwise have seen the European currency's share rise. Sterling's share rose to 4.7% from 3.9%, while the yen's declined to 3.8% from 4.2%. One reason for the fall in the yen share (apart from valuation effects) is that the People's Bank owns very low quantities of yen partly because of strains between Beijing and Tokyo. The dollar's share stayed unchanged at 64%, indicating how, behind the now partly lifted cover of exaggerated secrecy, the dollar's share in China's reserves has in recent years been very close to the international benchmark.