

Emerging Power of the Yuan and De-dollarization of the Global Economy

The US government shutdown and the debt ceiling crisis have increased global concerns regarding the impact of the dysfunctional US political system on the international financial system, in particular, and the global economy more generally. There is an increasingly-held view that US Treasuries are no longer “riskless assets” as the second debt ceiling crisis in just two years has now raised the spectre of possible US government default. This raises concerns about the US dollar’s position as the unrivalled global reserve currency. Several world leaders have expressed their concerns about the potentially destructive nature of the political brinkmanship in the US.

Heading for de-Americanization and de-dollarization?

The Chinese authorities have spoken about the “de-Americanization” of the global financial system. It is now more likely that there will be a systematic effort to reduce the dollar’s role at the core of the global financial system. At present, there is no viable alternative. There is no consensus to increase the role of the SDRs issued by the IMF. In the circumstances, the likely scenario is an increasing role for other international currencies, including the Euro, Yen and Swiss Franc. The Yuan is currently unconvertible. However, the Chinese authorities have already taken a number of measures to promote its internationalization.

Entry of the Dragon

The remarkable ascent of China in the global economy, particularly its vaunted export performance has led to a considerable strengthening of the Yuan in recent years. There is already an ongoing discussion, within China and outside, regarding the currency’s global role. The Chinese authorities have been cautious about the internationalization of the Yuan to date. It is still unconvertible; the exchange rate is managed; and capital markets are still shallow. However, there are signs that the Chinese authorities are creating the conditions for the further internationalization of the Yuan. The dysfunctional US politics is likely to accelerate this process. However, the liberalization is likely to be measured rather than an one-off effort. The following has already taken place:

- The conditions are being created to facilitate the inflow and outflow of capital.
 - The securities regulator has more than doubled the amount of Chinese shares that foreign investors can own.
 - Chinese enterprises are being encouraged to invest abroad
- Commercial banks in Hong Kong are permitted to accept Yuan-denominated deposits.

- Loans to developing countries are increasingly being denominated in Yuan.
- Intra-Asian trade is the most dynamic component of the international trading system and China's weight in this trade is leading to an increasing regionalization of the Yuan.
- The People's Bank (China's Central Bank) has now signed swap deals amounting to Yuan 2.2 trillion with 22 countries. These include the following;
 - China and the European Central Bank have signed a US\$57 billion currency swap deal. This means that the two central banks can exchange currencies and firms can settle trade transactions in local currencies rather than the US dollar.
 - The People's Bank and the Bank of England have signed a swap arrangement worth Yuan 200 billion. It is also noteworthy that UK banks hold Yuan 35 billion worth of deposits. This is likely to lead to increased Sino-UK trade and investment.
 - China's business dealings with other BRIC countries, particularly Brazil, are increasingly being transacted in domestic currencies. China and Brazil have a signed a swap arrangement of up to Yuan 190 billion.
 - China is Australia's largest trading partner. Australian businesses are increasingly settling their trade with China in Yuan. The Central Banks of the two countries have signed a swap arrangement for up to Australian dollars 30 billion.

As a result of all this, Chinese Yuan has, for the first time, become one of the 10 most internationally traded currencies in the world. It has risen from 17th position in 2010 to 9th in April of this year, according to the Bank of International Settlements (BIS's) latest report on foreign exchange turnover. Trading in Yuan has more than trebled over the past three years to US\$ 120 billion a day. The rise in Yuan trading is also a reflection of the international nature of China's manufacturing supply chains.

The dysfunctional US political system is also increasing China's soft power in terms of its model being seen as more appropriate for developing and emerging countries. This is also likely to give further impetus to the rise of the Yuan and its increasing internationalization. This will inevitably lead to the Chinese currency playing a greater role as a global reserve currency, particularly when China makes the Yuan convertible. This is expected in 2014.

Lets Join the Party

It is important to examine how Sri Lanka can take advantage of the increasing global role of the Chinese Yuan. Given the expected increase in trade following the FTA, the extremely large anticipated investments and the rapid growth in tourism, the following may be considered:

1. A swap arrangement between the two Central Banks to facilitate business transactions in local currencies.
2. Facilitate the use of Chinese credit cards by Chinese tourists and businessmen.

3. Consider the role of the Yuan in the Central Bank of Sri Lanka's reserve investment portfolio
4. Encourage domestic commercial banks to develop correspondent relationships with Chinese counterparts and facilitate RFC and NRFC accounts.

This is the Second article in the series of China Watch. Readers' comments are welcome at www.pathfinderfoundation.lk

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