It is Time to Accord RMB with SDR Recognition

China is now the largest exporters and the second-largest economy in the world. It is simply a matter of time that the renminbi ("RMB") would be included in the basket for the Special Drawing Rights ("SDR") of the International Monetary Fund ("IMF"), alongside the dollar, euro, pound and yen.

The Special Drawing Rights

The SDR is an international reserve asset created by the IMF in 1969 to supplement its member countries' official reserves. Its value is currently based on a basket of the four aforementioned currencies. SDRs are allocated by the IMF to its member countries and can be exchanged for freely usable currencies between members.

The five-yearly SDR review by the IMF shall take place at the end of 2015. It would be a major leap forward for China if the RMB is endorsed and added onto the SDR basket in the upcoming review. Upon its admittance, the RMB would cement its rising reserve currency status. This provides increased assurance to investors and companies worldwide who are already actively using the currency, and also accelerate further investments in the RMB.

China is actively trying to join the SDR but acknowledge that its admittance should be a natural process when the time is ripe. In order to qualify, it is crucial for the RMB to accelerate its internationalisation and at the same time reduce potential financial risks. Nevertheless, it would be ideal if the RMB is granted the SDR status now, while China continues to open up its economy.

The technical criteria – "Freely usable"

According to the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the RMB is the fifth most-used payment currency in the world and 27% of China's total goods trade is now settled in RMB. Supported by Beijing's strong policy backing, the internationalisation of the RMB is imperative.

Internally, the Shanghai Free Trade Zone has been spearheading pilot tests for China's capital account liberalisation. This includes the "two-way renminbi sweeping" program, which effectively allows free movement of corporate funds in and out of China. Outside of China, offshore renminbi centres led by Hong Kong, Singapore and London are providing a varied range of RMB hedging and investment products, as well as access to raise capital in the "dim sum" bond market, which is now worth a staggering RMB 750 billion.

With greater access to China's stock and bond markets for the foreign investors, the foreign exchange market for the RMB has indeed become significantly deeper and more liquid. Further, more than 60 central banks worldwide are holding investments, amounting to more than US$100 billion, in assets denominated in RMB. According to the People's Bank of China, the RMB now ranks seventh in reserve holdings globally. Hence, regardless of RMB's success in gaining the SDR status, the RMB is already a recognised currency in the eyes of many central banks.

Based on the above, it can be seen that the RMB do broadly meet the technical requirements based on the current "freely usable" SDR criterion as well as the potential new reserve asset criterion.

China's geopolitical influence

China is beginning to exert its geopolitical influence on the global stage, thereby enhancing RMB's chances of admittance into the SDR, starting with its leading role in establishing the Asian Infrastructure Investment Bank ("AIIB"), an international financial institution which aims to provide finance to infrastructure projects in Asia while giving a greater voice to emerging markets collectively.

The AIIB has proved appealing to even major powers like the United Kingdom, France and Germany. This reflects the growing awareness of the United States-dominated order's diminishing returns. From China's perspective, it seems unlikely to sustain domestic growth within the existing global system – a challenge that even Japan and the other East Asian economies did not encounter during their economic rise. Indeed the only country that has encountered this is the United States, when it replaced the United Kingdom as the world's dominant economic power before the Second World War. Fortunately, that precedent is one of accommodation and a peaceful transition.

In order to reach the world order, further reforms for China's financial sector are necessary to eliminate distortions in resource allocation and stem the economy's slowdown. The Chinese leaders' adamant refusal to pursue export-boosting currency depreciation, even in the face of decelerating growth, suggests their willingness to make necessary sacrifices in the name of securing the RMB's international role, which in turn, will be vital to China's long term economic growth and prosperity.

Regardless of whether the RMB will be added to the SDR basket in October, what is inevitable is the gradual transformation of the global system to accommodate China.

If you wish to understand more on the topic of the internationalisation of the RMB,
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