The paradox of China’s push to build a global currency

By James Kynge  Author alerts

Acceptance into global free markets needs liberalisation, writes James Kynge

We hate you guys.” This was how Luo Ping, a senior official at the China Banking Regulatory Commission, vented his frustration at the US in 2009. He and others in China believed that, as the US Federal Reserve printed money to resuscitate American demand, the value of China’s vast US Treasury bond holdings would plunge along with the dollar.

“Once you start issuing $1tn-$2tn … we know the dollar is going to depreciate so we hate you guys – but there is nothing much we can do,” Mr Luo told a New York audience.

These frustrations have been catalysts of great change. The authoritarian rulers of 1.3bn people felt an imperative to reassert control. Imbued with the resentful narrative of a “century of national humiliation”, they felt the prospect of the US squandering Chinese wealth was an indignity too far. In response, Beijing decided to hasten the promotion of the renminbi as a global currency. That way China’s exporters could earn “redbacks” rather than greenbacks, allowing their revenues to be invested at home rather than recycled into US Treasuries – the only pool of dollar liquidity big and safe enough to absorb significant investments from China’s reserves (which rose to $3.95tn at the end of March).

Therefore, the genesis of renminbi internationalisation, which will be a key theme during the UK visit this week of Prime Minister Li Keqiang, is indivisible from China’s aspiration to blaze its own trail rather than integrate into a Pax Americana in whose creation it had no say.

The scheme is showing signs of success. Financial capitals are competing for a slice of the fast-growing market in offshore renminbi. London plans to underline its credentials by designating China Construction Bank as a clearing bank for the currency. This should make trading in renminbi more efficient, more liquid and less risky. It could also attract Chinese companies keen to invest in Europe, and make it easier for investors to enter China’s capital markets.

The use of renminbi as a global payments currency is growing rapidly, though from a small base. In April it was the seventh most used currency, with 1.4 per cent of transfers, up from 0.6 per cent in January 2013, according to Swift, the international payments company. In the US the redback is also gaining a following, with the value of renminbi payments between the US and the rest of the world rising 327 per cent in April, compared with the value in April 2013.

At times, adopting the renminbi is portrayed as a snub to the US. Russian politicians have called for a “de-dollarisation” of their economy after sanctions imposed by the US and EU in response to Moscow’s annexation of Ukraine’s Crimea.

Such are the easy wins. Creating a genuine world currency will be much harder, rubbing up against the central paradox of China’s emergence: its political system relies on control while acceptance into global free markets needs liberalisation.

Institutions that hold renminbi have precious little scope to invest them. China has opened only tiny apertures for foreign investors in its domestic capital markets, promoting instead an offshore renminbi capital market that is as yet minuscule in comparison with its US dollar counterpart.

Jonathan Anderson, economist at the Emerging Advisors Group, estimates that in mid-2013 total capital market assets freely available to international investors in US dollars were worth $55tn; in euros, $29tn; in yen, $17tn; and, in sterling, $9tn. The renminbi offered a mere $250bn. “That is about 0.1 per cent of the global market, putting the renminbi on a par with the Philippine peso and just a bit higher than the Peruvian nuevo sol,” Mr Anderson wrote.

Of course, Beijing could throw open its capital markets but doing so might leave it at the mercy of the type of capital outflow that precipitated the Asian financial crisis in the late 1990s. It would also require the opening up of its state-owned banks, local government bond issuers and state companies to scrutiny from foreign investors.

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So reasserting one form of control would entail sacrificing another: winning a measure of from the “dollar zone” and the concurrent influence of the Fed would imply inviting in the oversight of global capitalism, the rules of which were written under Pax Americana.

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