RENMINBI JOINS INTERNATIONAL MONETARY FUND'S SPECIAL DRAWING RIGHTS BASKET: RATIONALE AND SIGNIFICANCE

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Executive Summary

1. The IMF (International Monetary Fund) reviews the composition and valuation of the SDR (special drawing rights) basket every five years. The latest review, released on 30 November 2015, decided to include Chinese RMB (renminbi) into the SDR basket on 1 October 2016.

2. The SDR was created in 1969 under the Bretton Woods system of fixed exchange rates to meet the shortage of liquidity as US dollar and gold, which are preferred foreign exchange reserve assets, could not meet the demand of global foreign reserves. With the collapse of the Bretton Woods system in 1973, SDR has played only a minor role since then.

3. The SDR basket is made up of five currencies, namely, US dollar at 41.73%, euro 30.93%, Chinese yuan 10.92%, Japanese yen 8.33% and British pound 8.09%.

4. The United States as a sovereign country that offers global reserve currency is unable to balance between short-term domestic and long-term international objectives. As a global reserve currency, the United States has to offer extra supply of its currency to fulfil world liquidity demand.

5. After the 2008 financial crisis, IMF realises that reforms are needed to gradually reduce the reliance on the US dollar as the only international reserve currency. It began to nurture super-sovereign reserve money where SDR is the most favourable candidate.

6. In practice, the usage of SDR is very marginal. The major implication of China joining SDR lies in the expected restructuring of IMF through letting SDR play a bigger role. When SDR becomes the super-sovereign money, RMB as a major currency in the basket would function like international money.

7. Joining SDR will also push forward China’s domestic reforms, particularly the exchange rate reform, to meet the standard of a real international reserve currency, which requires more skilful domestic and international policy coordination.

8. IMF will have to rely on its framework reform to resolve the conflict between domestic and international concerns of the United States; the framework reform will nurture super-sovereign reserve money, which requires RMB to join the SDR basket.

9. The inclusion of RMB in SDR will provide countries with an alternative reserve currency and with better stability. Countries may also want to gain from the RMB internationalisation process in the future. Supporting the inclusion of yuan in the SDR is apparently the first step towards boosting relations with China.

10. China has also made progress in expanding and enhancing the influence of SDRs, like the People’s Bank of China’s approval of World Bank’s inaugural issue of bonds denominated in SDRs in the Chinese domestic market.