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Inclusion of Yuan in the SDR basket

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Abstract

In what is being seen as another step in China's Global Economic Emergence, its currency the YUAN i.e. Renminbi will enter the SDR (Special Drawing Rights).

In this article we will be discussing about the inclusion of YUAN in the SDR basket, its impact and implications on the world Economy.

Keywords: Inclusion, SDR basket, Yuan

Introduction

Special Drawing Rights

The SDR is a type of international reserve asset that the IMF created in 1969 to buttress the Bretton Woods system of fixed exchange rates that was established at the end of World War II. Back then, countries could use gold holdings and widely accepted currencies to buy their local currencies overseas in order to maintain their exchange rates. But the supply of gold and the dollar could not keep pace with the growth in world trade or new developments in financial markets. So the IMF created an asset that could be exchanged for freely usable currencies. Countries are allocated SDRs in proportion to the IMF quotas they pay. They can use SDRs to make payments for future quota increases, to settle debts they owe to the IMF, which uses SDRs as a system of account, or to rebalance their reserves.

The importance of SDRs waned somewhat after the Bretton Woods system collapsed in 1973 and countries let their currencies move more freely in line with market forces. Still, SDRs came in handy during the global financial crisis when they helped supplement member countries' official reserves. As of September 2015, SDRs worth \$204.1 billion had been created and allocated to IMF's members. This number is equivalent to about \$280 billion.

Earlier, the value of an SDR is based on a basket of four currencies: the euro, Japanese yen, pound sterling, and the dollar. However the Chinese Yuan has been recently entered into it.

The International Monetary Fund on 30.11.2015 agreed to add the Chinese yuan to its reserve currency basket with effect from 01.10.2016.

After the inclusion of CNY, the SDR basket will include USD, EUR, CNY, GBP, and JPY. CNY will be given 10.92% weights in the SDR basket

Chinese Premier Li Keqiang on 24.03.2015 asked the International Monetary Fund (IMF) to include the Chinese currency in the special drawing rights (SDR) basket, endorse the yuan as a global reserve currency alongside the dollar and euro.

China is the second largest economy in the world, and the RMB has become the fourth most-used currency in global payments with a 2.79 percent share in August 2015, surpassing the yen, according to the Society for Worldwide Interbank Financial Telecommunication (SWIFT), and close to 25% of China's trade is now settled in RMB, compared to less than 5% in 2011.

International Monetary Fund Managing Director Christine Lagarde said in Washington on April 16 2015 that inclusion of yuan in SDR is a question of when, not if. China's yuan will be included in the SDR basket - currently made up of dollars, yen, pounds and euros

The decision — which marks another step in China's global economic emergence — came after the IMF evaluated the Asian nation's standing as an exporter and the yuan's role as a "freely usable" currency. In a statement, IMF Managing Director Christine Lagarde noted the yuan's inclusion is a "clear representation of the reforms" taking place in China.

On 30.11.2015 Lagarde (IMF Chief) said "The continuation and deepening of these efforts will bring about a more robust international monetary and financial system, which in turn will support the growth and stability of China and the global economy,"

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South Korea became the first foreign country to sell yuan-denominated debt in China's domestic market, drawing orders for more than four times the amount offered and setting a benchmark as issuance of such securities picks up. The 3 billion yuan (\$464 million) of so-called panda bonds were sold at 3 percent and drew bids of 12.8 billion yuan, according to a statement from South Korea's Finance Ministry. The sale of the three-year securities furthers China's efforts to open its capital markets to the world and comes two weeks after the Chinese currency won reserve status at the International Monetary Fund.

"It's an important milestone for yuan internationalization and will set a benchmark for more issuers," said Wang Ming, chief operations officer at Shanghai Yaozhi Asset Management LLP, which oversees 4 billion yuan of fixed-income securities. "For domestic investors, it's a good opportunity to diversify and foreign investors can access the market without having to study credit profiles of onshore issuers. The only problem is that liquidity is not good."

Effect of Inclusion of Yuan in SDR

- The yuan's inclusion in the basket sends a signal that the IMF believes that China's currency has the same global standing as the other four currencies currently in the basket which include the dollar, the euro, the sterling and the yen.
- The Yuan will become one of the currencies used in the disbursement and repayment of international bailouts denominated in the fund's accounting unit, like Greece's debt deal. One of the major impacts would be on the western countries. As the Yuan becomes more deeply woven into the global economy, it will undermine the ability of the West to impose financial sanctions on countries accused of human rights abuses and other violations, like Sudan and North Korea.
- It will make the Chinese Yuan a freely convertible currency and all other currencies will determine the value their currencies via *a vis* to Yuan
- The central bank of their countries especially Korea, Philippines and Indonesia plan to increase their Yuan reserves
- Global Organizations such as World Bank will now invest in Yuan dominated reserves when the SDR is updated
- As the Yuan is now officially recognized as a global reserve currency, China may attract more foreign investors such as sovereign wealth funds, especially because of accommodative monetary policies in Europe & Japan.
- Admission of the currency to the SDR basket would help build confidence in the long-term nature of the trend of wider international yuan usage, encourage more central banks to hold the yuan as part of their foreign exchange reserves and, by extension, the availability and demand for yuan-denominated assets,
- However although, the yuan is indeed added to the SDR, it remains far from replacing the US dollar as the top world currency. The US dollar accounts for 64 per cent of global reserve currencies and nearly 90 per cent of foreign exchange transactions. "There's no doubt the yuan will be widely used in the world, but it still has a long way to go

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