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CHINESE RMB PART OF THE SDR VALUATION FORMULA

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The International Monetary Fund (IMF) would be having its executive board meeting on November 30, 2015, in order to review the IMF's Special Drawing Rights (SDRs) basket composition, which is reviewed every five years by the Executive Board. The board would be considering whether to include the Chinese Renminbi (RMB) into the IMF's official basket of reserve currencies which includes the US Dollar, Euro, Pound Sterling and the Japanese Yen with current SDR valuation weights standing at 42 percent, 37 percent, 11 percent and nine percent respectively. If the board agrees to include the RMB into the SDR basket it would become the fifth currency, with a valuation weight that could be between 11 to 14 percent according to an IMF staff paper. This would be a very important symbolic victory for China since the inclusion of its currency into the SDR basket would signify the rise in its status in the international financial community and would commensurate its growing importance in the global economy- sending a clear signal to the world that the RMB is a very important international currency[1].

This would undoubtedly be a very important signalling to the international finance and commerce institutions and help divert attention away from China's current economic slowdown that has put global commerce and trade at unease. During an interview to the Wall Street Journal on September 22, 2015, China's President Xi while countering the question on the government's engagement with the IMF to get the RMB into the SDR basket as a result of the decline in China's foreign currency reserves and its capital flight witnessed in 2015; and while acknowledging the fact that there has been a drop in China's foreign reserves, assured that there still remains a large sum of foreign reserves by international standards at China's disposal. President Xi further added that with the improvement to the RMB exchange rate regime and progress in RMB internalization, it is quite normal that China's foreign reserves may increase or decrease[2].

It is pertinent to lay out the two criteria which determine whether a currency can be part of the SDR basket- firstly, the issuing country must be a major exporter, and secondly, the currency must be freely usable. China fulfils the first criteria, however, in case of the second criteria there still lie a lot of bottlenecks that China needs to address such as a free flowing currency, further devaluations, strict restrictions on the inflow and outflow of capitals and so on[3].

The interventions by the government during China's stock market downward free fall in the summer of 2015 throws light on one such bottleneck of strict government control over China's financial markets. However, China seeks to initiate economic reform as part of it's "comprehensively deepen reform" included in President Xi's "Four Comprehensives" that was laid out in February 2015. The admission of the RMB into the SDR valuation would have a great impact on China's reform process and this is why the People's Bank of China is most eager, among China's official institutions, in pushing for economic reforms. By bringing the yuan into the SDR it would give the bank a victory and help show that opening up the economy brings rewards[4]. The economic volatility faced by China as it continues to undergo reform in its economic growth model has brought about the need on its part to embark upon the reform process starting with the initiation in its financial sectors. The RMB, if included into the SDR basket of reserves, would be a first step towards this pursuit and whilst there is no real additional power that China would receive through this, it would provide a symbolic boost to its international standing where countries would start to keep the yuan in their foreign reserves, enabling the yuan to go truly global- henceforth, establishing China's coming of age on the global stage.

The inclusion of the Chinese RMB into the SDR valuation in itself is not of such economic significance and doesn't really matter much, since other considerations play a more important part, such as a country's IMF quota. What is significant are the salient outcomes of this in the form of reforms which is part and parcel of this currency inclusion, and it is these reforms that would unravel a major step up towards China's reform agenda. China is in the process of a major reform overhaul not only in its economic but in its military domain as well. Therefore, in order to realise its full potential in all these dimensions, and the need for China to increase its spheres of influence, the RMB by becoming a global currency of exchange, even though just symbolic, is a step in the right direction.

(Disclaimer: The views and opinions expressed in this article are those of the author and do not necessarily reflect the position of the Centre for Air Power Studies [CAPS])

Notes

[1]Masahiko Takeda, "Is the RMB in the SDR a Blessing for China", *East Asia Forum,* November 24, 2015,

http://www.eastasiaforum.org/2015/11/24/is-rmb-in-the-sdr-a-blessing-for-china/, accessed on November 27, 2015.

[2]"Full Transcript: Interview with Chinese President Xi Jinping", *The Wall Street Journal,* September 22, 2015, http://www.wsj.com/articles/full-transcript-interview-with-chinese-president-xi-jinping-1442894700, accessed on November 4, 2015.

[3]"The Yuan and the SDR: China Knocks on the reserve-currency door", *The Economist,* August 5, 2015, http://www.economist.com/blogs/freeexchange/2015/08/yuan-and-sdr, accessed on November 27, 2015.

[4]Ibid.