China Joins SDR Club

Nicholas R. Lardy says that the International Monetary Fund took a positive step by including the renminbi into the special drawing rights (SDR) global currency basket.

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Pedro da Costa: Hi, I'm Pedro da Costa, Editorial Fellow here at the Peterson Institute for International Economics and I'm joined by Nicholas Lardy, Senior Fellow here to talk about the big news of the day which is the International Monetary Fund's (IMF) inclusion of China in its special drawing rights (SDR) facility. Can you talk to us about how big a deal this is?

Nicholas Lardy: Well, I think it's very important for the Chinese. They've staked a great deal on this. They've undertaken a lot of reforms to come into compliance with IMF expectations. So, I think it's quite important for them. Certainly from a geopolitical point of view, it's quite important. I don't think it's going to have a big effect on anybody's economy in the short run.

Pedro da Costa: Okay. And what about as far as China's ability to make the renminbi a more international currency, does it raise its profile in that sense? Does it help China's cause in that direction? And what timeframe are we talking about?

Nicholas Lardy: It does raise its profile. I would say it's kind of like the good housekeeping seal of approval. It doesn't mean that other central banks are going to buy renminbi assets, but they'll probably look more closely at the opportunity to do so. And I would think over a period of years and decades the use of renminbi-denominated financial assets in the holdings of central banks would increase. But in the short run, I think central banks are very conservative organizations. Only a handful of them change their mix of reserves to be in accordance with the SDR basket. For most of them, a vast majority, it's entirely discretionary.

Pedro da Costa: What about the flipside, is there any chance that the IMF seal of approval puts more pressure on Chinese policymakers to either toe the line on reforms or to stick to them in any way? Or is it neutral in that sense?

Nicholas Lardy: I think it's slightly positive. I think it sets a series of expectations about the way the market will operate and transparency and the ability of foreign central banks and other major international financial institutions to participate in the market, both the onshore bond market and the onshore foreign exchange market which are two very important reforms that were initiated in order to meet the operational requirements of the IMF.

Pedro da Costa: Now, can you talk a little bit about the politics surrounding this accession now by China? There was a Chinese devaluation of the currency in August that some folks saw as them not necessarily playing by the global rules. The IMF seems to have a different interpretation and it saw actually it as making the yuan a little bit more flexible. What were the politics surrounding this and how did they play out?

Nicholas Lardy: Well, that move in August, on August 11th, followed by only a week or two after the issuance of the big report on the change or potential change in the basket, and one of the things that that report said was that the exchange rate of the renminbi needed to be more market-determined and the reform that they announced on August 11th was intended to accomplish that. I don't think it did in its entirety, but I think it was a step in the right direction. So, I think it was definitely seen by the central bank as a move that would put them more into compliance with IMF expectations.

Pedro da Costa: Okay. And do you expect any further devaluations in the near term?

Nicholas Lardy: Very difficult to say. Their currency has appreciated a lot over the last year in particular because it's going up along with the dollar since it's basically pegged to the dollar very closely. That has hurt their competitiveness in international markets. Their export growth is very weak. So, a lot of people think they're going to try to unwind part of this as we move through 2016. On the other hand, their current account surplus is actually expanding. It's very large which would tend to mean that you wouldn't expect a depreciation of the currency. So, I think it's anyone's guess exactly how it will turn out.

Pedro da Costa: Okay. Thank you so much. I appreciate it.

Nicholas Lardy: Thank you.