Eswar Prasad

Resistible rise: China's currency conundrum

A new book by Eswar Prasad asks whether China can win reserve status for the renminbi

© AFP

YESTERDAY by: **Henny Sender**

When Lehman Brothers imploded in September 2008, shaking the US financial system to its foundations, the dollar actually strengthened. Such is the privilege conferred by the world's pre-eminent reserve and haven currency. Whether the renminbi can ever achieve that status is what Eswar Prasad sets out to examine in *Gaining Currency*, a companion piece to his 2014 study *The Dollar Trap*.

Prasad, a professor at Cornell University and holder of a chair in international economics at the Brookings Institution, shows just how significant the advantages of such a status are — and how hungry Beijing is to claim them. Yet he sees little sign that China will embark on the liberalisation necessary for this to happen. His cautious conclusion is that while the renminbi has made remarkable progress, "it is far from assured that it will continue along the same impressive trajectory".

The interest of his study, though, lies less in that conclusion than in his description of the political and financial context of the renminbi's rise. For example, Prasad describes the sanctions imposed on Russia following its military action in Ukraine and seizure of Crimea in 2014, which in effect cut off the entire country from western financial markets. Russian tourists travelling abroad were unable to use credit cards, since the payment systems were in western hands. It was, Prasad notes, a powerful demonstration of "the leverage that the US and other western economies gain from having control of the choke points in international finance" — as well as being a shock to Russia's government.

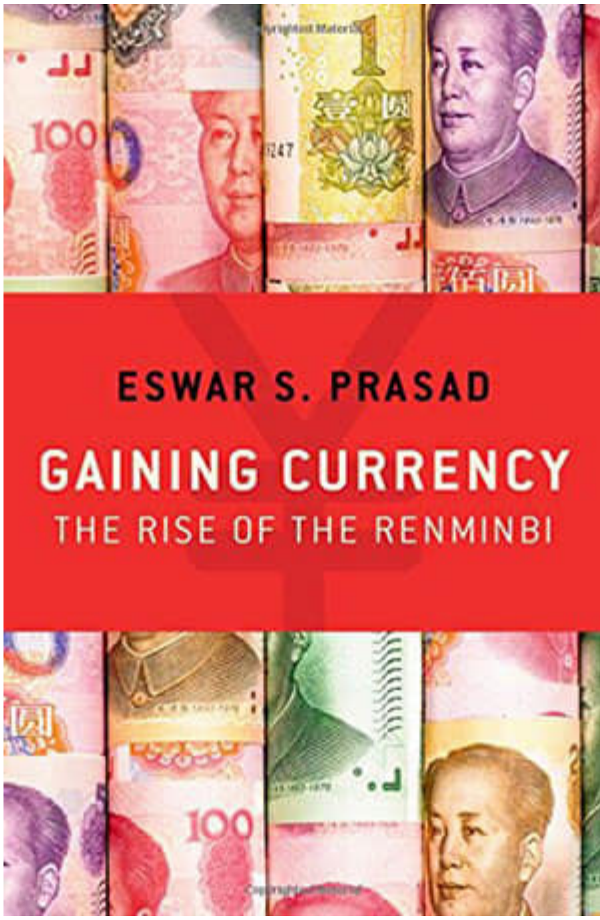
Part of the reason that Beijing wants to see the renminbi play a more dominant role in international finance is precisely to be more in control of its own fate, even as it frets about the volatility that might accompany widespread use of the yuan.

Had Prasad written his book even 18 months ago, he might have been far more positive about China. In spring 2015, the International Monetary Fund pronounced the renminbi fairly valued, after many years of US criticism that the Chinese were currency manipulators, keeping the exchange rate artificially low to support predatory export policies. In November of that year, the IMF announced that beginning on October 1 2016 it would include the renminbi in its special drawing rights basket, a symbolic victory for Beijing.

By the time of that announcement, however, fears were already mounting that China would itself become a source of instability. From the summer of 2015, the stock market plunged, capital outflows increased and the exchange rate started sliding. In the last months of the year, the People's Bank of China had to spend $415bn supporting the renminbi.

Prasad believes that without political reform, economic restructuring and a more robust financial system, China will have difficulty realising its ambitions for its currency. But that does not mean he has bought into the more dire predictions of many of his peers. Indeed, in one of his most interesting chapters, Prasad shows how China is still managing to create an alternative network of multilateral financial institutions, such as the Asian Infrastructure Investment Bank.

The only thing that Prasad does not speculate about is whether political developments in the US could cause the dollar to lose its own haven status — and all



the benefits that accompany it. Rather than two financial havens, perhaps soon there will be none at all.

Gaining Currency (https://www.amazon.co.uk/gp/product/0190631058?ie=UTF8&camp=1634&creativeASIN=0190631058&linkCode=xm2&tag=finantimes-21): The Rise of the Renminbi, by Eswar Prasad, *Oxford University Press, RRP£19.99/$29.95, 344 pages*

Henny Sender is the FT's chief correspondent for international finance

Photograph: AFP
