

Yuan Won't Rival Dollar Without Overhaul, Says Former IMF China Chief

By **Enda Curran**

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- Beijing wants the yuan used for payments around the world
 - Analysts say deep reforms needed before widescale take-up
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China's massive size and continued rapid growth mean that it's bound to climb up the world's economic and financial rankings, given time.

So it's striking when one seasoned China watcher makes a call that the nation's [currency](#) <https://www.bloomberg.com/news/articles/2017-06-29/yuan-rides-a-roller-coaster-in-june-as-china-fights-with-market> won't ever truly rival the dollar -- at least, without an overhaul in political and regulatory structures that the Communist Party has made clear isn't up for discussion. So says former IMF China division chief Eswar Prasad, author of "Gaining Currency: The Rise of the Renminbi."

Certainly, China's size as the second-largest economy and the biggest trading nation means the yuan is likely to continue to expand in use. Initiatives to welcome foreign investors, such as this month's [Bond Connect](https://www.bloomberg.com/news/articles/2017-06-30/china-hong-kong-bond-link-trading-to-start-monday-website-shows) link with Hong Kong, are also set to put the equivalent of billions of dollars worth of yuan in international hands. Even so, concerns remain about the ability to pull money out at will, and about safety of investments made in the country.



Eswar Prasad Photographer: Andrew Toth/Getty Images

"China's underdeveloped, volatile and weakly regulated financial markets will constrain the renminbi's ascendance as a reserve currency," said Prasad, now based at [Cornell University](https://www.bloomberg.com/quote/545745Z:US) .

That alone gives President Xi Jinping's administration a long to-do list -- one that officials are already working on. A National Financial Work Conference starting July 14 is set to debate a new structure [for financial regulation](https://www.bloomberg.com/news/articles/2017-07-11/china-is-said-to-mull-lead-role-for-pboc-in-financial-oversight).

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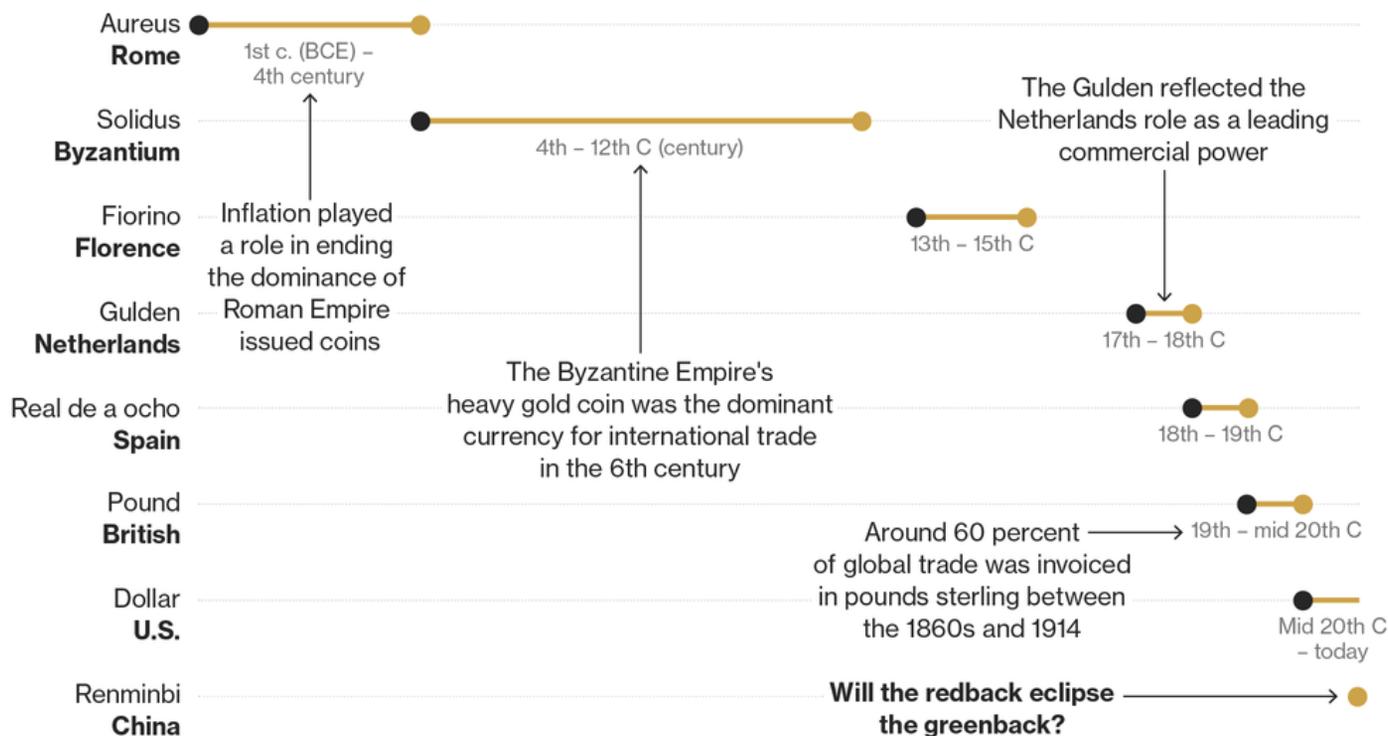
The offshore yuan [strengthened to the highest level](#) in more than a week Thursday, after comments by U.S. Federal Reserve Chair Janet Yellen hinted that the central bank may be in less of a rush to raise interest rates.

Achieving the safe haven status of the dollar, or that of a few others like Japan's yen and Switzerland's franc, that would take changes the Communist Party isn't to embrace, according to Prasad.

"It is unlikely to become a safe-haven currency in the absence of the rule of law, an independent central bank and an institutionalized system of checks and balances on the government," Prasad says. "These changes to China's legal, institutional and political structure are necessary to engender the trust of foreign investors -- the defining attribute of a safe haven currency. The current Chinese leadership has made it abundantly clear that such changes are not on the cards."

Good as Gold

Dominant currencies through history



Source: The World Bank, Classical Numismatic Group

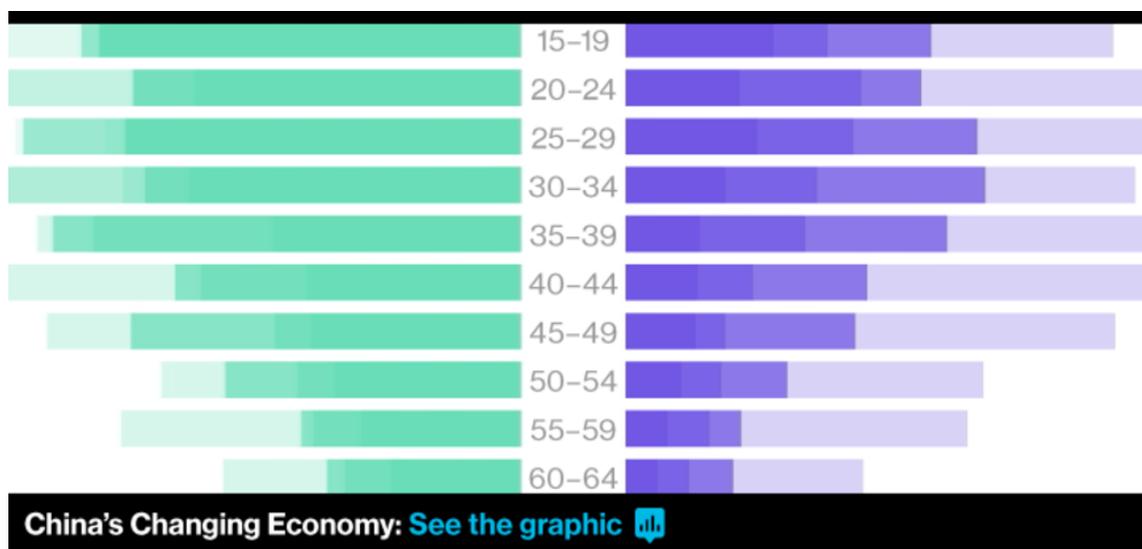
[Read here how even token dissent has subsided as Xi has amassed power at the top of the Communist Party.](https://www.bloomberg.com/politics/articles/2017-03-15/token-dissent-plummets-in-china-as-comrade-xi-s-power-increases)

<https://www.bloomberg.com/politics/articles/2017-03-15/token-dissent-plummets-in-china-as-comrade-xi-s-power-increases>

China's government has repeatedly pledged to push through reforms to reshape the economy and allow markets a greater say.

America's relative retreat from the world stage as President Donald Trump pursues a nationalistic policy mix is gifting China the opportunity <https://www.bloomberg.com/politics/articles/2017-07-08/trump-and-xi-skirt-north-korea-divide-in-excellent-meeting> to cement its ascending global role. From preaching -- if not practicing -- the merits of free trade and open investment to launching the Silk Road development plan, China aims to rearrange the international order.

And the yuan has come a long way, now the sixth most-active currency for global payments, according to according to the [Society for Worldwide Interbank Financial Telecommunication https://www.bloomberg.com/quote/3688887Z:BB](https://www.bloomberg.com/quote/3688887Z:BB)



<https://www.bloomberg.com/graphics/2016-changing-chinese-economy/>

In late 2015, the [International Monetary Fund https://www.bloomberg.com/quote/13347Z:US](https://www.bloomberg.com/quote/13347Z:US) decided to include the redbank in its elite basket of reserve currencies. Just last month, the [European Central Bank https://www.bloomberg.com/quote/2539Z:GR](https://www.bloomberg.com/quote/2539Z:GR) said it bought the equivalent of 500 million euros, in a new vote of confidence.

One sign of the challenges ahead: Standard Chartered bank's Renminbi Globalisation Index fell to 1,703 in May, its lowest reading in 39 months.

'Remarkable' Status

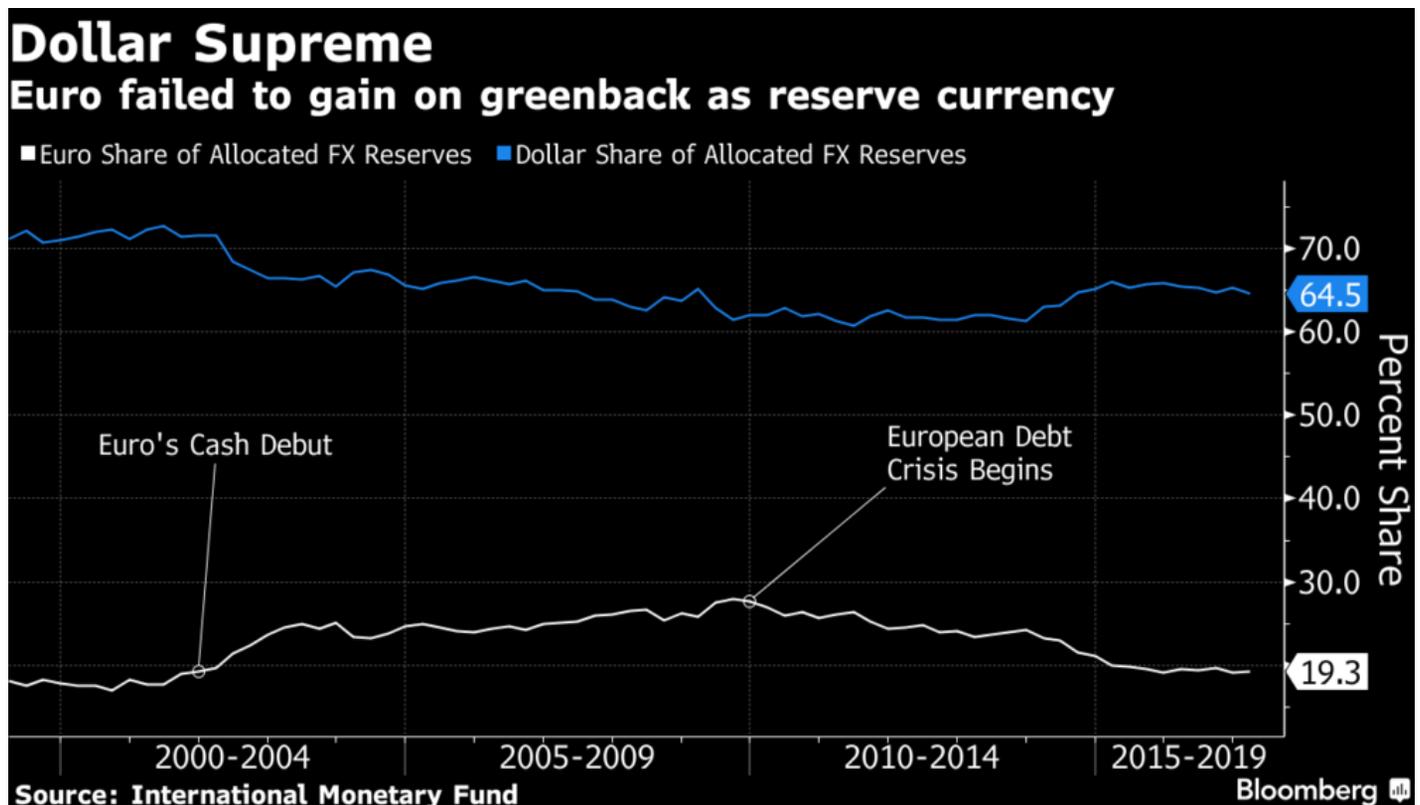
"It is remarkable that the renminbi has attained the status of a reserve currency even without the traditional prerequisites such as an open capital account and a flexible market-determined exchange rate," said Prasad. "In this, as in

many other dimensions, China's currency and economy are in a class of their own."

Even so, hopes for more wide-ranging market reforms have been dashed as authorities enforce strict rules on moving money into and out of the country and snuff out attempts by the market to push the yuan lower against the dollar. While a critical Communist Party leadership conference this fall could still re-set priorities, it's a far cry from the headiness of 2012, when [HSBC Holdings Plc <https://www.bloomberg.com/quote/5:HK>](https://www.bloomberg.com/quote/5:HK) analysts were predicting full yuan convertibility by 2017.

A rapid move to convertibility and opening up to [unbridled capital flows <https://www.bloomberg.com/news/articles/2017-07-06/china-rewrites-rulebook-on-capital-flows-after-crisis-lessons>](https://www.bloomberg.com/news/articles/2017-07-06/china-rewrites-rulebook-on-capital-flows-after-crisis-lessons) would carry its own dangers, not just for China but potentially for markets round the world exposed to a new source of volatility. Introducing checks on the Communist Party's power after a major widening in inequality of wealth could also have unpredictable consequences.

The yuan wouldn't be the first currency to [dash grand projections <https://www.bloomberg.com/news/articles/2016-09-14/china-s-reback-awaits-pride-of-place-with-dollar-rome-s-aureus>](https://www.bloomberg.com/news/articles/2016-09-14/china-s-reback-awaits-pride-of-place-with-dollar-rome-s-aureus). The yen has ended up largely on the sidelines of global finance since the Japanese economy crashed to Earth in the 1990s. And while the euro zone today has an economy roughly three-fifths the size of the U.S., and large and liquid markets for government bonds easily trade-able by international investors, the bloc's debt crisis and concerns about dissolution have curbed its ability to rival the dollar.



As Prasad puts it: "size goes only so far in the journey to become a major reserve currency."

