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THE CHOPPING AND CHANGING OF AUSTRALIA'S GOVERNMENT MAKES IT LOOK LIKE A PANTOMIME

Gareth Evans is Chancellor of The Australian National University



CANADA PROVES THAT STATE INTERVENTION IN REAL ESTATE IS NOT NECESSARILY A BAD THING

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The RMB could lead global currencies over the USD

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By Elizabeth Matsangou

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Chinese yuan bank notes in Shanghai, China. Aiming for more access to the global financial market, China is encouraging the RMB, as it is the world's second most important trade finance currency

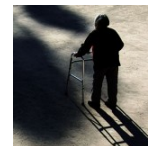
Since the 2008 financial crisis, global currencies have continually fluctuated. Now, discussions are mounting at whether the RMB could displace the USD

The 2008 financial crisis forced institutions and states around the world to examine the vulnerabilities that allowed their exposure to such a calamity. Some blamed the deeply integrated global economy for the onset of the reverberating crash, while others found fault in overzealous banking sectors.

In any case, in the trying years that have since followed, both responsible and afflicted parties have set about introducing an overarching set of reforms to resolve prior mistakes in the hope of preventing a disastrous reoccurrence.

Both developed and developing economies alike have felt the strain, with the resulting recession disrupting even the seemingly unstoppable rise of China. Thus, after over three decades of an annual GDP growth of 10 percent, Beijing found itself facing an unexpected economic downturn for which it was not responsible.

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From a drastic decline in exports to a hard hit on its manufacturing industry and resultant job losses in the millions for individual cities, a rude awakening forced China to examine its financial system, and assess whether it was best suited for its interests.

“Most importantly, the subsequent decline of the US dollar exposed their reserves of about \$4trn to huge book losses. They reasoned, as did leaders of some other countries, that if more of their transactions and more of their holdings were denominated in other currencies, or better in their own currency, they would be far less exposed to such risks”, said Dr William H Overholt, co-author of *Renminbi Rising: A New Global Monetary System Emerges*.

Chances of success

On November 30, China reached a new milestone in its ongoing penetration of the global economy when it was announced by the IMF that the RMB was approved as a main world currency. The move, which sees Beijing join an elite and exclusive group of just four others (the US, the eurozone, the UK and Japan), enabled the use of the RMB in trade and international finance thereafter.

Attaining reserve status required “the currency be ‘freely usable’, which is defined as being ‘widely used’ for international transactions and ‘widely traded’ in the principal foreign exchange markets”, said a statement published by the IMF.

The internationalisation of the RMB thereby bears several advantages to businesses around the world, which can now benefit from cheaper and more efficient transactions. “The availability of RMB trade finance has been absolutely essential to maintaining world trade in the aftermath of the global financial crisis (GFC)”, Overholt explained. “Companies trading with China can often structure deals much more efficiently when they have the option of denominating the deal in RMB.

A market-based RMB will cause far fewer economic distortions than the old, highly managed system. When China is the largest trader of a commodity, it may be more efficient to have the price of that commodity denominated in RMB.”

Moreover, from a broader perspective, the widespread availability of derivatives denominated in the RMB should help companies to hedge against financial risks, as well as better manage various other fiscal situations.

What’s more, in the event that states have greater diversification of currency reserves, including the ability to access the RMB in a crisis, they may become more robust and, therefore, less susceptible to losses than would be the case if reserves continue to be dominated by the USD.

Of course, the heights that the RMB can rise to depend upon several factors, with various challenges to overcome along the way. In order to become an integral global currency player, Beijing must sustain rapid economic growth in the long term, which is somewhat precarious given its current slowdown.

Dismantling China’s current capital controls is also required so as to fully open up the RMB, while a greater volume of international trade and investment transactions must also transpire for it to achieve dominance in the sphere.

Furthermore, as Overholt told *World Finance*: “They need to grow their domestic bond market, which is now about 10 percent of the size of the US counterpart, and unify it so that it is a single, highly liquid market, rather than the fragmented market under four different regulators that prevails today. Perhaps most difficult for China, it will have to convince market participants that the legal system can settle disputes in an objective and fair way; today a Communist Party commission still oversees all verdicts.”

In conjunction, China’s ongoing shift towards a market-based economy is vitally important in maintaining fast levels of growth, while also consolidating its place in the global economy. This transition requires a series of judicial and governmental reforms

China’s ongoing shift towards a market-based economy is vitally important in maintaining fast levels of growth, while also consolidating its place in the global economy

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from Beijing, as well as a continued steadfast focus on its current anti-corruption campaign.

Further economic development also entails more efficient and sustainable resource allocation, coupled with a marked move away from the strong bias given to state-owned enterprises through preferential capital access. Investment will be naturally encouraged through the creation of a more competitive market, as will greater efficiency and innovation.

Dislodging the US

Naturally, the rise of the RMB has significant implications for the US as the current leader of the global monetary system. Given the impact that the global financial crisis had on the US in terms of its position and the vital level of trust it commands from international players, damage was caused, which in turn has aided China's growing prominence in the international system.

Although it will take years, if not decades for the RMB to seriously challenge the USD, the long journey towards achieving such a feat has already begun. At present, the RMB is beaten only by the USD as the world's leading currency in traded finance, while it is swiftly growing as both a settlement and trading currency.

In addition, through Beijing's creation of institutions such as the Asian Infrastructure Investment Bank and the Silk Road Fund, China is consolidating its place in a shifting global economy, while also actively increasing its bargaining power as a global currency. The case of the latter is further advanced through the opening of capital markets and RMB transaction centres around the world, as well as the strengthening of financial institutions through market reforms.

"These reforms are happening quickly in historical terms – far more quickly than they happened in, for instance, Japan and South Korea. Having said that, Chinese leaders face challenges in changing the country's economic model, surmounting a financial crisis, and overcoming political opposition to further reforms", Overholt added.

"So far, the emergence of the RMB as the second most important trade finance currency has been extremely valuable to a trade system endangered by the GFC, and its emergence as an important settlement currency has enhanced the efficiency of global settlements.

Eventual diversification of reserve holdings, and the expansion of emergency swap arrangements, could be quite beneficial. But there are important risks going forward. The best case would be that the USD and the RMB end up supplementing each other in complementary ways and that the Bretton Woods institutions and the new Chinese-developed institutions become complementary."

Yet, as explained by Overholt, in the event of opposing trade, monetary and geopolitical blocs, disintegration of the global economy could occur, which would thereby drastically reduce economic growth. "Moreover, if we ever do come to a point where the RMB can challenge the USD, history shows, as our book, *Renminbi Rising*, details, that the transitions can be treacherous and even risk depression or war if not handled wisely. We are quite dependent on sound leadership from both sides of the Pacific."

All too aware of the growing might of China and the RMB, the US has shown clear reluctance in accepting its increasing influence in the global financial system. Particularly as illustrated by Europe's faster response to RMB internationalisation through the swift establishment of support infrastructure, such as settlement centres.

As such, the US seeks to quell any would-be challenges to its global prominence in all spheres. However, the US is a historical anomaly in its enduring position as the world hegemon – for decades it has commanded military, economic, ideological and political leadership in the international arena. Arguably, the lynchpin of this dominance is its monetary prowess, and any challengers to this carefully guarded position must not be underestimated – China is certainly no exception.

Perhaps the RMB will never dislodge the premiership of the USD, yet it cannot be denied that the possibility exists, even if it is within an indefinable time frame. The internationalisation of China's currency, therefore, marks a new stage in the global economy – a new era for the position of China among the world's elite.

Given the size of its economy and population, its continued development industrialisation and technological advancement – China is a force to be reckoned with.

And now, with the marked and deliberate evolvement of its regional and international influence through ventures such as the AIIB and the Silk Road Project, in which the usually dominant US actually has no power, China is on the road to indirect control of pivotal markets, thereby spreading its influence over far more than just its own territory.

As such, it would seem that the 2008 global financial crisis is not only pivotal for the economic impact that it continues to make, but crucially, for the political implications and consequences that we are far from fully grasping at present.

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