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Renewed SDR of the IMF Goes into Operation
—China needs Stability of Domestic Economy—

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New SDR got a peaceful start

On October 1, 2016, the IMF launched a new computation system for its Special Drawing Right (SDR) adding the RMB in the basket. The new basket now consists of five currencies of US dollar, euro, RMB, yen and sterling pound. The conversion rates were decided at the board meeting held on September 30 with the fixation of each currency value (total of which equals to the SDR), enabling the daily computation of the SDR value[1].

The new SDR interest rate to be applied for the week starting October 10 was announced on October 7 as 0.1390%, 0.089 point higher than the rate of 0.050% that was applied a week earlier[2]. This will lead to a moderate cost-push for the countries (mainly developing countries) that have borrowed from the IMF.

A sense of uncertainty remains

A good start of the SDR opens a way to the RMB to be more broadly used in the sovereign transactions among the finance ministries and central banks of the IMF member countries. The IMF has given a high praise to the efforts of the Chinese government up to now.

However, in the world of international financial transactions, the RMB is still a currency bound by many national regulations. The disruption between onshore market and offshore market remains with no free conversion between them. The RMB still is a quasi-international currency clad with a sense of uncertainty.

For example, China is not a formal member of the OECD. It is likely to continue to pursue its national interest in full scale by using different positions of a big power and a developing country on a case-by-case basis. It is difficult to predict how China will behave once the international financial system becomes destabilized. This sense of uncertainty may be unfounded. However, it is strongly hoped that China takes an action to dispel such apprehension.

1 Refer to the URL below on the Board decision on September 30. 2016.
http://www.imf.org/external/np/pp/eng/2016/093016.pdf
2 Refer to the following site on the interest rate of the SDR.
https://www.imf.org/external/np/fin/data/sdr_ir.aspx

China needs to stabilize its domestic economy

When the IMF decided at the Board meeting of November 2015 to include the RMB in its SDR basket, it required the Chinese government to promote the economic and financial reforms,[3] which included full reform of currency exchange regime, abandoning the current managed floating regime within a few years.

It is also true that the present financial sector of China has been saddled with topics of vulnerability, including the rise of housing bubbles in many cities, and mountain of debt, a part of which is non-performing loan. In such an environment, it is unclear whether China can implement such exchange rate reforms and financial liberalization in a few years as the IMF has been demanding. If China dares to implement these reforms, the vulnerability of the Chinese economy would come up to the surface and spill over to the other countries.

China has many domestic inconsistencies and difficulties including the large income differentials and needs to overcome them under one party control regime. In order for China to shift to a more complete free-floating regime in its exchange rate system, it is also required to strengthen the stability and improve the transparency in the spheres of domestic politics and economy.

[3] Please refer to the following website for the press release of the Board meeting on November 30, 2015 http://www.imf.org/external/np/sec/pr/2015/pr15540.htm