

## Yuan as new global currency? It can bode well for India

The fact that World Bank President Robert Zoellick has said that China's yuan may become the global reserve currency over the next 15 years assumes significance not just for the world but also for India. It has the potential to make Indian goods relatively more competitive as the Chinese currency today is highly controlled.

This is not the first time Zoellick has spoken of such a possibility and the buzz about China trying to position the yuan as a reserve currency of the future has been on for some time now. This is not a situation that will occur in the short or medium term, but surely a prospect over the time frame that Zoellick is talking about.

With bilateral trade between the two Asian giants estimated at around \$41 billion in 2008-09, China has now become India's largest trading partner. The trade, however, continues to be lopsided. Exports from India are valued at about \$9.7 billion while imports are as high as \$31.33 billion.

No wonder India's Ambassador to China S. Jaishankar recently made the point that it was strange Indian manufactured products were competitive globally but not within China. Clearly, there are growing concerns not only over the trade deficit but also over the fact that most of India's exports to China are commodities while imports are mainly manufactured goods.

The fact that Chinese goods are more competitive than the rest of the world is also being attributed partially -- though not wholly -- to the fact that the yuan has not been allowed to float freely against other currencies, primarily the dollar. In case a free float was allowed, it would be bound to appreciate and this would naturally make its products less expensive.

At the same time, the overall cost of production of Chinese-manufactured goods is also much lower than in many other countries mainly due to low wages of workers along with the economies of scale achieved by setting up large capacity units.

One of the main reasons for the expected appreciation of the yuan is the mountain of China's foreign exchange reserves currently estimated around \$2.3 trillion. It has the largest reserves in the world. India is at the fifth place but far below the Chinese level with nearly \$300 billion.

The rumblings about the yuan being considered a reserve currency began early this year when China suggested that SDRs (special drawing rights) of the International Monetary Fund should be given a chance as the new reserve currency. It was felt this could pave the way for making yuan as a major backing currency for the SDRs. Currently, the yuan is not in the basket of currencies for the SDRs but is expected to be included in the next review in 2010.

In addition, since December 2008 China has undertaken currency swaps estimated at \$95 billion with central banks in South Korea, Malaysia, Belarus, Indonesia, Argentina and Hong Kong. This would enable importers to make payments in yuan for Chinese goods without going through the usual dollar route.

Though the yuan is now in the news, till only recently, the euro was viewed as the prime contender for becoming the next reserve currency of the world. In fact, Zoellick has in earlier comments noted that there could be two alternative reserve currencies, the euro and the yuan.

The World Bank president has also sought to warn the US that unless it deals with issues like debt and budget deficit its dollar may no longer be the world's predominant currency. He has also suggested that the euro or the yuan need not replace the dollar but could become an alternative to it.

This is in line with the views of several countries like Russia, India and China that have been arguing that the old Bretton Woods formula, which placed the dollar at the centre of the global financial system, needs to be drastically altered to reflect the new world order. Besides, these countries feel the growing US debt is weakening the world's financial system. Hence the proposals for multiple reserve currencies rather than a sole pivotal currency.

Making the yuan an alternative reserve currency would certainly make life much simpler for countries like India, which have growing trade relations with China. It would be easier to make purchases directly in the Chinese currency than operating through the dollar.

At the same time, it must be recognised that making the yuan as an alternative reserve currency is a long way away. The yuan or renminbi as it is also called has to be 'internationalised' as Mr. Zoellick puts it. It has to be made free-floating as its movement against the dollar continues to be tightly controlled by Chinese authorities. In fact, the current yuan-dollar market is also quite illiquid in contrast to the rupee-dollar market.

In this backdrop, it is clear that the first step that China will have to take is to free the yuan from controls and let it find its own level. This is bound to harden the yuan against the dollar and thereby make Chinese goods more expensive. To what extent this would hurt China's competitiveness is yet to be seen. The US of course has been protesting the controls on the yuan especially since it has a huge trade deficit with China.

Other countries like India, South Korea, Japan, Taiwan and Thailand are also concerned about the fixed rate of the yuan. Their currencies have appreciated against the dollar but the yuan remains steady. The rupee, for example, has already appreciated by about six percent against the dollar over the last six months, creating difficulties for exporters who say their products will become uncompetitive.

In such a scenario, with China adamant on keeping controls on the yuan, it looks as if it may take a really long time for the currency either to internationalise or metamorphose into the one of the world's new reserve currencies.

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