

## **Analysts mixed on yuan's demand**

**KINIBIZ ONLINE**

**DECEMBER 1, 2015**

**STORY BY G. SHARMILA**

Analysts were mixed on the recognition of the yuan as a global reserve currency, with some saying that demand for the currency would increase, while others expressed scepticism that it would.

Standard Chartered said the inclusion of the currency in the International Monetary Fund's Special Drawing Rights (SDR) basket has "significant, game-changing effects on the rest of the world's markets".

According to Standard Chartered, central banks are likely to favour products such as yuan bonds issued by the Chinese government, policy banks, high quality corporate bonds and Supranationals; and at the shorter-end of the curves, T-bills and bank deposits.

It expects rising usage of the yuan by corporates, financial institutions and investors.

In a statement today, Standard Chartered's Greater China and North Asia chief executive officer Benjamin Hung said: "We are expecting further steps to include flexible cross-border investments and remittance, expansion of free trade zones and greater opening up of capital account. We are confident that China will remain committed in promoting its currency in a steadfast and well-paced manner, and will be on track to meet our forecast of becoming a G3 currency by 2020.

He added: "In the interim, there will inevitably be uncertainties and volatilities across financial markets, be it greater two-way US dollar-yuan variability or financial flows, as international investors and reserve managers adjust their portfolio over time. It is important to brace ourselves for these developments as it takes time for market participants to rebalance against a new reserve currency, which will eventually bring positive changes to global financial markets across FX, rates, fixed-income and other asset classes."

After the SDR review, Standard Chartered said it expects a gradual pick-up of diversification inflows into yuan assets from international investors and reserves

managers, of which the latter would be a critical underlying support for the yuan in the coming years.

Standard Chartered also said it expects inflows of US\$85 billion (RM361.55 billion)-US\$125 billion (RM531.69 billion) from global central banks in 2016, with at least 5% of global reserves being denominated in yuan by end-2020.

Meanwhile, MIDF Research believes that the yuan's inclusion to the reserve currency will only give a limited impact to the demand for the yuan, although it will impact how the People's Bank of China manage their currency.

“The fact that yuan is recognised as an international currency should give more room to the currency to deviate from US dollar, leading to further depreciation in its currency relative to US dollar.

“From an economics point of view, the fact that yuan was getting stronger against most of its major trading partners due to its managed floating mechanism (which could clearly be seen that the major currency in its basket is US dollar), while at the same time China have been conducting expansionary monetary policy (which should lead to a depreciation in its currency), may cause China to shift its exchange rate policy to be more market-oriented – or at least to be less dependent on US dollar, which should lead to slightly further depreciation of yuan to the US dollar in the short-mid term period,” the research house said in a report today.

Global ratings agency Fitch Ratings was also uncertain if demand for the yuan would receive a boost from inclusion into the SDR currency basket.

“New incremental demand for yuan arising directly from joining the SDR is likely to be marginal, and it remains unclear to what extent it will boost broader long-term usage of the currency among reserve managers,” it said in a statement yesterday evening.

It noted that being a part of the SDR basket is not a sufficient condition for the yuan to be considered a reserve currency, nor will it necessarily result in a sudden spike in the allocation of reserves to yuan assets.

“Notably, other currencies such as the Canadian dollar and Australian dollar are currently held more widely as central bank reserve assets without being a part of the SDR basket. Furthermore, yuan-denominated assets do not currently qualify as

foreign reserves according to the IMF – despite the inclusion of the yuan in the SDR weighting – because of China’s capital controls,” Fitch said.

According to Fitch, the inclusion in the SDR basket is neither a quick fix nor an alternative to the broader structural reform agenda.

“The speed at which the yuan develops into a global reserve currency will depend on the extent to which central banks and sovereign wealth funds begin to see the currency as a viable store of liquidity and value to rival that of the US dollar. Such a shift is only likely to be gradual. It is especially unlikely in the short term so long as doubts persist over China’s prospects for a smooth and orderly macroeconomic rebalancing,” it opined.

Fitch noted that China’s authorities only aim to lift capital controls by 2020, which means that the full convertibility of the yuan remains a way off.

“Furthermore, access to yuan assets among foreign investors remains very small despite the tremendous growth in China’s economy and the role it plays in global trade. The market for yuan-denominated debt securities remains small, and it was only this year that China allowed foreign central banks access to its domestic bond market,” it added.

“Joining the SDR basket may be symbolically significant for China, and marks a growing role for the country in international financial institutions more commensurate with the size of its economy.

“The policy process that enabled joining the SDR basket also contributed to a number of reforms to liberalise and partially open China’s capital markets. As such, Fitch believes that joining the SDR could strengthen the economic reform process, and will enable the authorities to resist pressures to reverse any reforms to market liberalisation,” the ratings agency said.

**© 2015 KINIBIZ. All rights reserved.**

Source: <http://www.kinibiz.com/story/markets/203635/analysts-mixed-on-yuan%E2%80%99s-demand.html>