The IMF will include the yuan in SDR currency basket

The International Monetary Fund (IMF) is raising the Chinese yuan to the rank of major currency by adding it to the currency basket used to calculate the value of special drawing rights (SDRs). The yuan will carry a weight of 10.92%, compared with 41.73% for the U.S. dollar, 30.93% for the euro, 8.33% for the yen and 8.09% for the pound sterling. This will not take effect until October 1, 2016 to give the IMF and the users of SDRs time to adjust.

SDRs were created by the IMF in 1969 to supplement the official exchange reserves of its members. They do not really constitute currency, nor do they constitute a claim on the IMF. They can, however, be traded for currencies under agreements signed by countries, or at the IMF’s request. The current total amount of SDRs outstanding is 204 billion (approximately US$280B). The SDRs are allocated to each country in proportion to its quota within the IMF. Those allocations have been increased only four times over the years, with the latest increase dating back to 2009.

Only the currencies of the main exporting countries are considered for inclusion in the SDR basket. Moreover, it must be possible to use them freely on a broad scale. For many years now, there has been no doubt about China standing among the main players in international trade, but the freely usable criterion had yet to be demonstrated. The reforms that Chinese authorities have implemented in recent years to make the yuan more accessible and increase its use abroad (especially by central banks) appear to have convinced the IMF. But it is still very far from being a fully convertible currency, as is the case for the other currencies that make up the SDR basket.

There was also one other important constraint for the yuan to be recognized: China needed to develop its money market, in particular by increasing the number of issues, in order for the IMF to be able to get a fair measurement of the country’s short-term interest rate. That measurement will be used in calculating the interest rate to be applied to the SDRs. The IMF’s member countries pay and collect interest on their allocations and their holdings of SDRs, respectively.

Implications: The IMF’s announcement represents a landmark in the integration of China into the international monetary system. It is also a strong sign of recognition for the Chinese currency. However, this is not likely to result in any marked expansion of its role as a reserve currency in the short term. It is important to mention that the amount of SDRs outstanding is still very low compared with the total official reserves of the central banks which amount to around US$11,500B. The bulk of the official reserves is held in the form of low-risk government bonds and, consequently, the outstanding amount of available securities is a significant variable. In this regard, the Chinese bond market is a small one compared to those of the other countries whose currencies are included in the SDR basket.

The small size of the Chinese bond market will curtail use of the yuan as a reserve currency

On a different note, other reforms will have to be adopted to increase the accessibility of the yuan and its use around the globe. In particular, China will have to allow its currency to float more freely, and further remove capital controls.

Hendrix Vachon
Senior Economist