



Global Reserve Currency: Little Real Alternative To Dollar

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Calls by China and Russia for a new global reserve currency – possibly based on the IMF's special drawing rights (SDRs) – reflect Beijing's and Moscow's concerns about a potential decline in the US dollar, and by extension, the value of their own substantial dollar holdings. Indeed, yesterday was the second time in as many weeks that China has adopted this line – previously it expressed concerns about the safety of its investments in US government securities.

Truth be told, it's difficult to see a viable alternative to the dollar. I am not sure if Chinese central bank governor Zhou Xiaochuan actually has in mind the yuan as a potential reserve currency, but the fact that the People's Bank of China has in recent months extended the yuan equivalent of tens of billion dollars in swap lines to South Korea, Hong Kong, Malaysia, Belarus and Indonesia suggests that it sees the renminbi as a regional anchor of sorts.

Even so, could the yuan – or any other currency – usurp the dollar? Let's look at the alternatives. The euro is still too tenuous. There's no guarantee that the euro will survive in the long run. Meanwhile, the yen isn't widely used enough (the carry trade notwithstanding), and Japan's long-term economic decline suggests that its currency will also lose significance. Moreover, investing in Japanese Government Bonds (JGBs) instead of US Treasuries is hardly appealing, given the low yields on offer for such a high debt pile (170% of GDP).

With Japan being overshadowed by a rising China, it is thus natural to speculate about the possibility of a yuan block in Asia. But the yuan is not even fully convertible, and while this will eventually change, it's difficult to see it outshining the dollar – especially on a popular level. In fact, I'd wager that most people outside Asia could not name the yuan as the Chinese currency, let alone commit to shifting their cash holdings into yuan.

Furthermore, while I think it is natural for countries such as China and Russia to want to diversify their reserves, I'd say that their calls for a new reserve currency also have a strong political whiff to them. Not coincidentally, both countries would like to see the end of US hegemony, and one way of achieving this might be to erode the dollar's dominance – although not quickly, obviously, lest a dollar collapse hurt their own economies.