

Could the Chinese yuan act as the main international reserve currency?

The question of where China's currency fits in the global financial architecture is again a live issue for debate.

Questions are being asked as to whether the currency - the renminbi (RMB) or yuan - could work as a reserve currency alongside or perhaps instead of the US dollar (USD). Various arguments are put forward. First, China now generates 18% of global GDP compared to the USA's 15% (measured at parity purchase power), and represents 14% of international trade, against 10% for the USA. This is why the IMF has, since 2016, included the RMB in the basket of currencies used to determine the exchange rate of special drawing rights. Additionally, sanctions against the Russian Central Bank and, more generally, the United States' willingness to use financial sanctions as a weapon have led some countries to increase the share of RMB in their central banks reserve allocation and develop trade deals settled in RMB.

Nevertheless, we do not think the RMB, in its current or digital form, will replace the dollar as the world's main reserve currency in coming years.

Despite its 'weaponisation' (freezing of dollar assets, throwing countries out of SWIFT, extra-territorial rules on dollar assets), currently there is no alternative to the USD as the main international reserve currency. For one thing, any country aspiring to have a reserve currency has to run persistent current account deficits in order to supply the rest of the world's demand for its currency (a country running a trade deficit is said to be exporting its currency). At the moment, only the United States can play this role (Chart 1). China's balance of trade remains firmly in the black and we cannot see it turning lastingly red in the medium term.

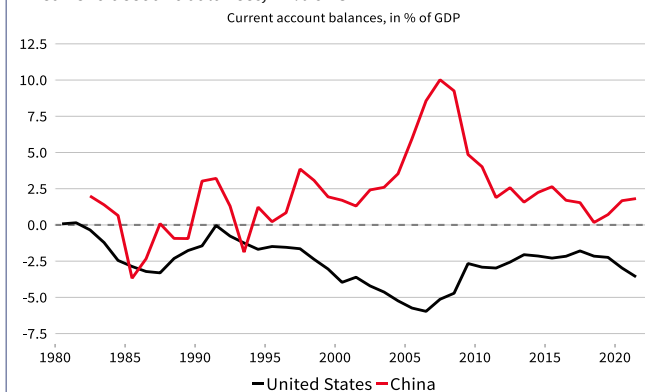
Another reason why the USD will remain the world's reserve currency for the next few years is that it enjoys strong 'network effects', basically deep and open capital markets, the institutional capacity (via the Federal Reserve) to act as lender of last resort and a key role in the financial services used by the rest of the world.

Network effects explain why the USD is far and away the most popular currency used in commercial and financial transactions (Chart 2), even between non-American counterparties. As China's capital account remains closed, foreign investors find it hard to access RMB-denominated assets on the scale required. As long as China maintains substantial capital controls, outside investors and central banks will worry less about the dollar's theoretical 'sanctions risk' than about major political uncertainty in China. The restructuring of the Evergrande group's debt offers a case in point, raising the possibility that foreign creditors will end up losing more than home-grown creditors.



The US dollar's reserve currency status is based in part on recurring current account deficits

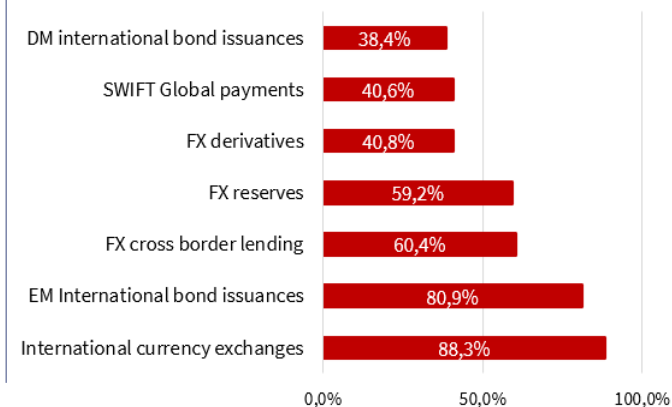
Current account balances, in % of GDP



The US dollar remains the preferred currency for global financial operations

Share of the dollar, in %

Share of the dollar in financial operations



Past performance should not be seen as a guarantee of future returns.

All data taken from Bloomberg, Macrobond, (06/05/2022). In accordance with the applicable regulation, we inform the reader that this material is qualified as a marketing document. CA012/H1/2021

OUR MACRO COMMENTS

Events of the week



The price of oil is rising again after the European Commission unveiled on Wednesday its proposed embargo on Russian oil by the end of 2022. If this unprecedented round of sanctions against Russia were to be approved by the governments of the European Union, many of them would give up the supply of their first supplier. The price implications would be massive.



Initially well welcomed by markets, the Fed's decision to raise its key interest rate by 50 basis points (in line with expectations) was quickly dismissed by the still overwhelming concern on the markets regarding the United States' growth prospects. The Nasdaq index even recorded a 5% decline – a first in two years – driven by a drop in major US technology stocks.

Figures of the week



- ISM Manufacturing PMI Index (April)
- ISM Services PMI Index (April)
- Policy interest rate



- Retail sales (in month on month variation, March)



- Caixin Services PMI Index (April)



- Policy interest rate

	Current		Consensus	Previous
	55,4	↓	57,6	57,1
	57,1	↓	58,5	58,3
	1%	↑	1%	0,5%
	-0,4%	↓	-0,1%	0,4%
	36,2	↓	-	42
	1%	↑	1%	0,75%

The week ahead

Monday



Trade balance (April)

Wednesday



Inflation (April)



Inflation (April)



Inflation (April)

Thursday



GDP (Q1)



Industrial production (March)

Friday



Michigan consumer sentiment index (May)

Sources: Bloomberg, on May 6th, 2022.

MARKETS PERFORMANCE

Interbank rate

	Last.	-1W	-3M	YTD	-12M
€STER O/N	-0,59	-0,58	-0,58	-0,59	-0,57
USD SOFR O/N	0,30	0,28	0,05	0,05	0,01
JPY TONAR O/N	-0,02	-0,02	-0,02	-0,02	-0,02
GBP SONIA O/N	0,69	0,69	0,20	0,19	0,05
CHF O/N	-0,78	-0,78	-0,78	-0,78	-0,79

Long term sov. rates

	Last.	-1W	-3M	YTD	-12M
10Y OAT	1,51	1,31	0,45	0,20	0,06
10Y Bund	0,98	0,81	0,03	-0,21	-0,23
10Y BTP	2,96	2,58	1,42	1,17	0,89
10Y JGB	0,22	0,25	0,17	0,07	0,09
10Y Bonos	2,08	1,80	0,86	0,56	0,44
10Y Swiss	0,86	0,79	0,10	-0,13	-0,22
10Y Gilt	1,98	1,85	1,30	1,02	0,93
10Y USTnote	2,93	2,82	1,78	1,52	1,59

Credit & EM

	Last.	-1W	-3M	YTD	-12M
EUR Corporate Aaa	1,67	1,49	0,59	0,33	0,18
EUR Corporate Baa	2,44	2,23	0,95	0,66	0,46
GBP Corporate Baa	2,85	2,68	1,83	1,52	1,17
USD Corporate Aaa	3,64	3,56	2,51	2,13	2,10
USD Corporate Baa	4,59	4,48	3,03	2,60	2,44
USD EM aggregate	6,35	6,20	4,69	4,33	3,91

Commodities

	Last.	-1W	-3M	YTD	-12M
Brent, USD/BL	110,14	4,9%	23,3%	39,3%	60,7%
Or, USD/oz	1 881	-0,2%	4,1%	2,9%	5,3%
Copper, USD/metric ton	9 481	-4,1%	-3,7%	-2,1%	-5,1%
Platinum, USD/onz	977	7,4%	-6,0%	1,0%	-20,5%
Palladium, USD/onz	2 286	4,9%	-3,8%	15,6%	-23,7%
Silver, USD/onz	22,60	-4,4%	-0,8%	-2,1%	-14,1%

FX rates

	Last.	-1W	-3M	YTD	-12M
EUR/USD	1,05	-0,5%	-7,0%	-7,0%	-12,3%
EUR/CHF	1,04	1,6%	-0,2%	0,0%	-5,4%
USD/GBP	0,80	0,0%	8,5%	8,4%	11,3%
USD/JPY	130,00	1,3%	13,7%	12,9%	19,0%
USD/BRL	5,01	-0,3%	-5,4%	-10,0%	-6,9%
USD/CNY	6,61	0,7%	3,9%	4,0%	2,1%
USD/RUB	65,83	-11,2%	-13,7%	-12,2%	-12,0%

Equity indices

	Last.	-1W	-3M	YTD	-12M
MSCI AC World (USD)	1 110	1,7%	-5,2%	-4,4%	-0,5%
Eurostoxx 50	3 725	-0,3%	-11,8%	-13,3%	-6,9%
Dax 40	13 971	1,3%	-10,5%	-12,0%	-7,9%
CAC 40	6 396	-0,8%	-10,1%	-10,6%	0,9%
FTSE 100	7 493	0,9%	-1,2%	1,5%	6,5%
SMI	11 880	-1,4%	-3,9%	-7,7%	6,9%
SP500	4 300	2,8%	-6,3%	-9,8%	3,2%
TOPIX	1 898	2,0%	-2,0%	-4,7%	0,0%
iBovespa	108 344	-0,9%	-3,2%	3,4%	-9,4%
Hang Seng	20 870	4,6%	-12,3%	-10,8%	-26,6%
Sensex 30	55 669	-2,0%	-6,5%	-4,4%	14,4%
MOEX	-	-	-	-	-
CSI 300	4 016	3,1%	-12,0%	-18,7%	-21,6%

Source: Macrobond, on May 6th, 2022.

1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7-year returns. Figures are rounded.

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