



Does China Seek a Global Role for Its Currency?

Morris Goldstein discusses the China-Japan currency pact signed in December—and why Beijing faces obstacles in its bid to elevate the global role of the yuan.

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Steve Weisman: In December of 2011, Japan and China reached an interesting agreement about currency that I'm going to talk today with Morris Goldstein of the Peterson Institute. This is Steve Weisman. Morris, what was the agreement that Japan and China reached?

Morris Goldstein: The two countries agreed that they would use their own currencies rather than the US dollar when doing trade with one another. So they'll have an increased role of the Chinese yuan and the Japanese yen in trade transactions. Japan also agreed to hold more of its reserves in yuan.

Steve Weisman: Was China going to hold more of its reserves in yen by the same token?

Morris Goldstein: I think the agreement was mainly for yuan holdings in Japan. At least, that's the part that I think got the most play. Also, Japan would support the sale of bonds denominated in Chinese yuan for Japanese companies in Tokyo. So in a sense, it increases the role of the yuan regionally.

Steve Weisman: I think some said, "This portends another step in the decline of the dollar as a global currency." Was that overstated?

Morris Goldstein: I felt it was overstated. I think that's really premature for the following reason: for the international role of the yuan to increase very significantly, it would have to become more attractive to all kinds of investors and traders. For that to happen, it would have to be more widely used. That means you would have to be able to use the yuan freely not just for handling exports and imports, but all kinds of capital transactions in and out of China.

But suppose the Chinese were willing to do that. They would lift restrictions on various kinds of outflows and some inflows. Well, then Chinese savers would find that they have an increased set of choices and opportunities to get a higher rate of return. And similarly, Chinese borrowers would be able to lower their borrowing cost.

And this in turn, would have a whole set of implications. Chinese banks now get quite a lot of their profitability because of a large spread between lending rates and deposit rates. Deposit rates are very low. Lending rates are high. So lending rates would come down, deposit rates would go up and the profitability of the Chinese banking system would go way down.

So you might say, "Well, what's the big deal of that?" Well, that also leads to a chain of events. If Chinese banks lose a lot of their profitability because of the spread, then they're going to be less willing to do a whole set of transactions that they currently do with the Chinese government and Central Bank that assists China's exchange market intervention and sterilization. For example, those banks now make deposits at the Central Bank at very low interest rates. That's a loser, but they don't want to do it if they're not making up for it by the interest rate spread. And they now hold all these so-called sterilization bonds also at low interest rates.

Steve Weisman: The sterilization is intended to prevent inflation.

Morris Goldstein: That's right. With China doing so much exchange market intervention to keep down the value of the RMB [renminbi] or yuan, you need to mop up that extra liquidity. And that's how they do it, by selling these bonds and asking the Chinese banks to put all these deposits at the Central Bank. But if you didn't do the sterilization, then inflation would go up, which is very unpopular.

Alternatively, if you cut the exchange market intervention because you can't do the sterilization anymore, then the value of the renminbi increases. It appreciates, which means Chinese exports are lower and employment in those export industries is lower, which is also unpopular.

So my main point is once you tweak the international role of the yuan and you say, "Well, I want to really increase that," that sets off a chain reaction of a bunch of other policy choices that are much more fundamental. So I don't see that happening in the short term. It may happen over a much longer time period, involving decades, not a couple of months or even a few years. So we ought not to hold our breath for the yuan overtaking the dollar.

Steve Weisman: Do the Chinese want the yuan to take over the dollar?

Morris Goldstein: I think they would like it to be much more important than it now...

Steve Weisman: But they're unwilling to ...

Morris Goldstein: I think that's the point that's been underplayed in the debate.

Steve Weisman: All right.

Morris Goldstein: It's not simply a matter of the size of the Chinese economy or the fact that the Chinese want the yuan to become more important internationally. For that to happen, they would have to give up things in other areas of policy that they currently don't want to give up. So it's not a win-win situation. It would involve difficult choices for them.

Steve Weisman: It's sort of like be careful what you wish.

Morris Goldstein: That's true.

Steve Weisman: So what was this step with Japan? Was it just like a gesture to signal to the world that they want to throw their weight around regionally, but the whole world concludes that they're not really prepared for the role that their actions imply?

Morris Goldstein: I think it's more than a gesture. It's another small step in a series of measures to increase the international importance of the yuan. But they're doing that at a very controlled pace so they don't have to make some of these more fundamental policy choices that I was mentioning. That means that it's going to take a long time if they do it at this pace.

Steve Weisman: Thank you, Morris.

Morris Goldstein: Thank you.

