Global Currency Dollar: What Next?
Is Yuan Currency to Replace or Other

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Abstract: The global reserve currency is the one which forms the largest proportion of the holdings of central banks. More broadly, it is also the currency most likely to be accepted by merchants worldwide. The debate about whether the dollar will be replaced by the yuan is a bit of a red herring because such a shift will not occur quickly. As of 2010, about 60% of all foreign-exchange reserves were denominated in dollars, giving the US currency a critical mass. Investors are still comfortable with holding it; despite the country's fiscal problems, in times of crisis, the dollar is regarded as a haven. It will take a long while for international investors to become confident that a Communist-led government will always respect their rights. The Yuan has the potential but it will take another decade or two if china starts promoting the currency strongly. If we see the macro-conditions it is in favor of china but have to improve the law. Even euro was having the same view but the current crisis going on in European countries may not be favourable for the currency in the international market. Well this had to be look after in the further analysis.

Purpose – The purpose of this research paper is to find out whether Yuan or any other currency may replace dollar in terms of reserve currency or trading currency or whether the Bretton woods system would be revisited if crisis occurs.

Design/methodology/approach –

1) The Research will be mainly based on secondary Data collection, analysis and interpretation.

2) Use of examples, charts and tables will be made to explain the intricacies of the Concept.
3) Article from Journals and Reference Books will be referred for understanding the reasons and the facts for the depreciation of the Indian Currency.

Findings – The findings would depend upon the analysis done, but according to the literature it is found that the dollar would remain a reserve currency more 15 to 20 years but still the opposite could be expected.

Research limitations/implications – The limitation of this paper is that the findings may or may not happen if the macro economic conditions of the countries change dramatically.

Practical implications – The implication of the paper is to just understand whether there will be drastic change over an international currency market or will remain the same

Originality/value – The charts and analysis will be used by taking into consideration by using some econometric model.

Keywords: Bretton Woods pact, multipolarity, hyper-efficient markets, etc.

Executive Summary:

The paper is apropos, if any probability of Yuan becoming the next world reserve currency? As we know dollar has played a dominant role as a reserve currency. After the 1978 and 2007 World Crisis, dollar’s position has changed as Current account deficit and US debt has increased. In 1980 the US debt as a percentage of GDP was 25.777% which increased to 45.936% in 1990 and in 20th century increased to 73.101% for 2010. Meanwhile, Yuan’s exports to all Asian countries and World have increased because the labour is cheap in china and products are exported at very lower prices. This has affected the local markets production of different countries as Chinese products are cheap. With this GDP of china has been increasing in 1990 it was 3.8% which increase to double in 2000 which was 8.4% and in 2011 it was 9.1% (GDP Growth Annual, The World Bank). China’s currency Yuan or (REINMIBI) has a long way to become a World reserve currency because even after dollar, Euro, SDRs the country has to be politically strong, Economic size, Trade and External Financial Strength, Economic reforms also play an important part. China’s relationship with major economies such as US, Japan, India and Russia will also determine the success of Yuan. If China is unable to garner the support of these economies, which are expected together constitute around 60% of World GDP in 2030, the crowing of the Yuan as the global reserve currency would be next to impossible. (Nishant, 2010)

We will support our thought with some data and facts.

Preamble

Since 1940s, U.S. dollar has served as a main reserve currency of the world. Dollars are used throughout the World as medium of exchange and Unit of Account, and many nations store wealth in dollar - denominated assets such as Treasury Securities. (Carbaugh and Hedrick, 2009). The acceptance of Global currency reserve is generally determined as one of the form, largest proportion holdings of central bank (which is accepted by Merchants Worldwide). A reserve currency is determined by these fundamentals – the economic size of a country – includes GDP, trade and external financial strength – the currency’s value should be preserved through low and stable inflation by a country i.e macroeconomic stability. Even though Switzerland is a small country Swiss Franc is used as a reserve currency. In today’s situation China has a chance to
overcome America reason being the rising US indebtedness and china’s strong financial and economic prowess. To put it other way China’s trade is large, although the economy is small, it has become a net creditor to many nations and US has become a net debtor. As a store of value Yuan exchange rate is expected to rise over a period of time and dollar’s value will decline. Nations like Nigeria and Chile want to use Yuan as a reserve not only as asset but want to satisfy private – public sector demand.

China will take some 10 – 15 years to become a reserve currency, as it has to create a market environment and policy to have Yuan as a global currency. Capital account is closed and that is why Yuan is still not convertible and freely available. The financial system is repressed and government controlled, with this the financial markets lack the sophistication to provide liquidity for currency to be attractive.

Many economists are commenting that there are chances of Yuan appreciating by 1% and others are arguing that it would depreciate by 1% for year 2012.

**Dollar Dominance as a Global Currency:**

The transition of dollar – pound, where US had started focusing on imports of raw materials and exports of manufactured goods. Pound was playing the role of international reserve currency built on the gold standard. After the World War I pound became very weak and Federal Reserve was established in 1914. At that time US had high hopes of replacing Pound, but the aftermath might have affected the overall stability of countries holding Pound as the reserve currency. In 1924 and 1927 US had helped Britain to restore the gold standard by lowering its discount rate. The interest rate change was done to open the gap between dollar and Pound. With this interest changes Britain could return to Gold Standard at Pre – war Parity in 1925 and 1927. The reason for The Great Depression (1929 – 1933) was because of Stock market crash as Britain could not maintain the convertibility of pound, for this reason it left the gold standard in 1930. The fear of dollar devaluing increased the conversion of dollar into gold by different countries. US abandoned gold standard in 1933.

In the year 1934 dollar was most attractive currency because it was convertible in gold. In 1944 the Bretton Woods System was formed and dollar became the major reserve currency. According to Mundell, the Bretton Woods System was neither a gold standard nor a dollar standard (Mundell, 2003) it was both. When different nations started using dollar as a comfortable exchange reserve currency dollar became stronger than any other currencies. About 64 percent of World’s official foreign exchange reserves are held in dollars, and about 86 percent of daily foreign exchange trades involves dollar (Bank of International Settlements, 2007).

**The question is why was US eager to replace Pound?**

Firstly, Compared to the 19th century US economy had relatively started opening in the 20th Century. The involvement in World Trade and Capital markets increased. Secondly, for dollar as a World dominant currency it was very convenient and cheap to get the resources in its own currency. The concept of Seignorage {Seignorage is the revenue that the government makes from the gap between the cost of printing notes and minting coins and there nominal value. (Mc Neill, 2005)}. This means the risk of exchange rate fluctuation and transaction cost for third party transactions.

**Does Yuan have a chance of becoming next global currency?**

In the developing countries China has performed well and a decade it will become a high income country. The GDP growth is be almost same at US. From the fiscal management point China has
already performed similar or more than Europe and US. China’s economic prominence may shift from exports to domestic consumption, as it has wealth has educed. China should float its currency to have major economic power. 

During the 1997/1998 Asian Crisis and the 2007-2010 World Financial Crisis and Economic Crisis, China has proved to be a stabilizer for East Asia and the World (Gunther Schnabl, 2010). Global Financial Crisis gave a fair chance of cross-border use of Yuan. Currency used internationally provides lots of advantages. Firstly, it reduces the risk of exchange for private and public sectors and transactions of domestic currency can be done internationally. Secondly, financing of debt can be done by issuing its own currency. As the World’s banker, it can also borrow “Short” at low rates and lend “long” at higher yields, earning the spread, while as the world’s “venture capitalist” (Gourinchans P – O & H Rey, 2005), it can sell liquid, domestic - currency - denominated high - debt domestic grade to finance (domestic – currency – denominated) illiquid high return assets (Hausmann & Sturzenegger, 2006). Sustainability of net debtor position could be achieved in long run. Thirdly, International competitiveness could be beneficial by increasing the no of investors in financial market. Fourthly, the international use of reserve currency benefits as the value purchased per unit of commodity is raised. 

Comparison of China and US: 

The inspiration of US and China is the same. In the past, switching of the reserve currency from Pound to dollar shows a guideline, that chances of Yuan becoming reserve currency are by the mid of 20th century. In the year 1870 Britain lost its position to US as a largest economy and largest exporter. After this scenario, US became the net creditor and Britain became the net debtor. In 1945, dollar became the World reserve currency replacing the Pound. Comparing to the past at the time of Britain Pound and US dollar transition similar case is now with China being the net creditor and US has become the net debtor. China is on its way to become the largest exporter. The historic correlation doesn’t say that the addition of Yuan as a reserve currency is not mind-boggling.

As the capital markets and foreign investment are concerned China’s opening has to be done, which is already done by US and Britain way back. China has to make currency fully convertible for transactions, by decreasing the restrictions on money entering and leaving the country. Continuing with the domestic financial reforms and making bond markets more liquid. In 2009, selected companies used Yuan to settle transactions in Hong Kong, Macau and Asian countries. China and Russia have entered in bilateral agreement for increasing the use of their currencies. Countries like Malaysia, South Korea, Indonesia and Hong Kong have made currency swap – agreements with China for making the import payments.

The US General government net debt Figure 1 which is percentage of GDP indicates the healthy state of the economy. The debt – GDP ratio was 25.777% in 1980 and in 2009 the debt – GDP ratio was 58.83% by the year 2017 it is estimated to increase about 88.422%, according the IMF. The long term soundness of US debt is a question because the fiscal pressures are increased. The international role of dollar has become uncertain due to the fiscal bearings. Large scale deficits are there because under the perception of US treasury securities that dollar is the World’s only safe and liquid asset. This is the reason why there is long – term unemployment and hindered the progress of fiscal reforms. After a period US treasury will be less attractive in the market because of such reasons.
In the year 1980 the current account balance of US was 0.083% which increased to –4.184% in the year 2000 and is expected to be –3.53% by the year 2017, according to IMF. The reason is US had spent more on imports compared to exports. Broadly speaking there are two main theoretical explanations for the persistence of this deficit, as well as diverging views of its seriousness. One focuses on the rise of export-oriented economies in Asia and the desirability of investment in US capital markets. This explanation posits that there is a “global saving glut” which sees emerging economies wishing to park their export revenues in a stable and liquid currency, creating a surplus of capital inflows that must necessarily mirrored by a matching deficit in the current account. The other main explanation focuses on the high level of US government debt and dis-saving by US households, arguing that the current account deficit is driven by profligate household spending that will persist in the absence of policy reforms (World Economic Forum, 2012).
The International Investment Position shows the direct investment abroad has increased. The dollar diplomacy was achieved by US as it became the net creditor in the 19th century.

This diagram shows even though the position of population which will increase to about 1.47 billion in 2050 and for US it would be 419.9 million. From the trade point of view exports was 1.201 trillion for china which is still less than the exports of US. The imports are also less for China. But a persistent growth in the economic reforms and politically strong relations with different Asian and Developed countries would give a chance of Yuan replacing the dollar.
Conclusion:

If the United States continues to spend and borrow at its present pace, and the Federal Reserve maintains an easy monetary policy with low interest rates, the dollar’s status as a reserve currency likely will continue to erode. When the world’s growing demand for liquidity subsides
as economic conditions return to normal, the United States could eventually lose the privilege of being able to have the world’s main reserve currency. In spite of these uncertainties, there is a shortage of currencies that could replace the dollar as the main reserve currency. To retain the dollar’s reserve status, the Federal Reserve must be prepared to tighten its monetary reins. Doing so will not be easy, particularly since large federal deficits probably will force lawmakers to increase taxes, thus slowing future investment and growth. The demand for reserve currency has increased over a decade and dollar doesn’t have a dominant role. Still China has a long way to become the global currency.

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