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MARKETS

IMF Details Hurdles to Yuan Reserve-Currency Bid

Market restrictions pose difficulties that could push decision into next year



PHOTO: BLOOMBERG NEWS

By IAN TALLEY

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WASHINGTON—China will likely have to move ahead with market liberalization before the International Monetary Fund labels the country's yuan a reserve currency, IMF officials said Tuesday, signaling a decision could be pushed into next year.

If China's government doesn't move fast enough to remove restrictions on

market access, it could force the IMF to postpone a decision on Beijing's bid to get the yuan included in the elite basket of currencies that comprise the fund's lending reserves.

Although Beijing has outlined plans to liberalize its financial markets, the yuan doesn't currently meet the IMF's key criteria for reserve currencies to be "freely usable," meaning countries could face problems trying to buy and sell the currency in a pinch.

"Access to onshore markets in China would be important, as would a free interest rate, a market-determined interest rate," a senior IMF official said as the fund published a preliminary assessment of the yuan's fitness for inclusion in its reserve basket. There is not enough depth of yuan trading in international markets and significant gaps in financial data, the fund official said.

Chinese officials in recent days have signaled their intention to press ahead on liberalizing the country's financial markets and allowing foreign investors greater access to Chinese securities despite a stock-market rout and unprecedented government intervention that raised questions about Beijing's commitment to reforms. For instance, the central bank last month scrapped the quotas limiting the investments by foreign central banks, sovereign-wealth funds and other big financial institutions in China's \$6.1 trillion bond market.

In a statement posted on its website Tuesday, the People's Bank of China said it will continue to carry out market-oriented financial reforms and keep the yuan's exchange rate stable at a reasonable level.

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Getting the yuan labeled a reserve currency would allow Beijing to flex its muscle more in the global economy, a key step in boosting its role in the world at a time when it is challenging U.S. political and economic dominance in global affairs. It would likely accelerate demand for the currency, especially by central banks.

Still, the U.S. sees Beijing's bid as an opportunity to spur policy overhauls opening up China's largely closed markets. The yuan isn't likely to challenge the dollar's pre-eminence in the global economy for years to come as investors and countries around the world have far more confidence in the greenback as a fungible and secure asset, economists say.

While China has gained backing in its endeavor, Washington has hedged its support, trying to leverage Beijing's endeavor to encourage a stronger revamp of the financial sector. Managing Director Christine Lagarde, meanwhile, has said the IMF is likely to award the yuan reserve-currency status at some point, but left the timing open.

"The report signals that the decision about the yuan's inclusion in the basket will hinge on financial market development, further opening of the capital account, and greater exchange rate flexibility," said Eswar Prasad, a Cornell University professor and former top China official at the IMF.

The IMF is seeking greater investor access to China's foreign exchange and security markets and wants Beijing to deepen its financial system by creating new currency-hedging instruments and offering more government debt securities.

Even if China moves ahead with market overhauls that move it closer to meeting the IMF's criteria, the senior fund official said "the ultimate assessment by the board will involve a significant element of judgment."

Despite Beijing's vows to move ahead with market-opening plans, U.S. officials have raised concerns that turmoil in recent weeks could slow the pace of those efforts.

"The landscape will change, there is no doubt in my mind," the senior IMF official said. "How much it changes, I can't tell you."

The fund may buy China more time to make that decision by extending the period in which any changes to the IMF's basket of currencies become effective. Normally in its five-year review of those reserve currencies, a decision late in the year becomes operationally-effective on the first of the year. But IMF staff propose the board extend that to September of 2016 this time.

"This could open the door for a positive decision on the yuan's inclusion in the [IMF's] basket if the Chinese government makes a firm commitment to undertake reforms and policy actions needed to enhance the currency's free

usability over the next year,” Mr. Prasad said.

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