


 sponsored  
article

# Cooperation is the best policy

With greater numbers of global representatives at the G20 table, reaching an agreement whereby the major players can work together to create solid currency policies seems a distant dream, says Simon Derrick



SIMON DERRICK

**"2009 has already provided plenty of evidence of conflict given China's clearly expressed concerns over its exposure to the US dollar"**

The path towards G20 becoming the premier forum for 'international economic cooperation' (usurping the role of G8) seemed inevitable this year. Given the scale of the crisis that overwhelmed the financial markets last year, it was inconceivable that the world's major foreign exchange (FX) reserve holders would not have a seat at the table when these matters were discussed. However, although this move is certainly to be applauded, it brings with it its own unique set of problems.

There can, of course, be little debate over whether this decade has been characterised by imbalanced growth globally. Moreover, few could argue with the contention (reportedly carried in the US proposal for the G20 summit) that the US needs to save more (and cut its budget deficit), that China must rely less on exports, and that Europe needs to make structural changes to boost business investment. However, achieving consensus on why these problems emerged in the first place has not been easy. In particular, reaching agreement among the key members of G20 on some of the currency policy issues that have contributed to these imbalances has already proved difficult.

## AT THE HEART OF THE MATTER

**There is an argument that says the key relationship within G20 is that between the US and China; to truly understand the tensions within the group, it is vital to understand the interplay between the two.** More particularly, if we are to identify how (or whether) G20 will tackle currency issues then we need to pick apart how the relationship between the US and China has developed this year.

The rapid emergence of a fresh trade dispute in mid September between the two nations is a crisp reminder of how volatile their relationship can be. Indeed, even without this, 2009 has provided plenty of

evidence of conflict given China's clearly expressed concerns over its exposure to the US dollar. The response from the US has, to a large degree, been a muted one, with Treasury secretary Timothy Geithner reiterating, when necessary, that "a strong US dollar is very important in the United States" and that he expects it to remain as the "principal reserve currency" for a very long time. However, one interesting variation to this theme did emerge in early September.

Speaking at the World Economic Forum meeting in Dalian, Dr David Dollar (the Treasury's newly appointed economic and financial emissary to China) argued that the US government is concerned about overall demand for treasuries rather than the demand from individual nations. He also noted that "yields on long-term US treasuries are at historical low levels. It shows the market is confident that the US can bring its fiscal problem under control". Although hardly dramatic, this seemed to serve as a subtle rebuff to his hosts, implying that others did not share China's concerns about the US fiscal position. However, it was his comments on China's FX reserves that proved rather more notable. He stated: "The general issue is that China has a huge amount of reserves and it makes a lot of sense for it to diversify. I think it has reached a point that it is healthy to have a variety of different reserve-type of currencies." He then went on to state: "We welcome the internationalisation of the Chinese yuan (CNY)."

The former World Bank's country director for China and Mongolia's comments certainly make sense. Moreover, his statement that the Treasury welcomed the internationalisation of the CNY was entirely consistent with the drive by both the Bush and Obama administrations to push China to increase the pace of currency liberalisation. Nevertheless, it was curious to see the

Treasury's first permanent representative in China (with explicit responsibility for engaging with China on monetary and exchange rate policy) talking so positively about reserve diversification, and saying that it is healthy to have a variety of different reserve-type currencies. Not only has this process, arguably, been one of the key factors behind the US dollar's slide through most of this decade, but his comment also came at a time when the US dollar was under renewed pressure.

It could, of course, be the case that Dr Dollar was simply making a straightforward statement of the facts as he personally saw them. After all China did add a further \$186bn (€127bn) to its reserves in the first half of this year, taking their overall value to an astonishing \$2,130bn. To put this into context this represents around 30 per cent of total FX reserves globally, as well as a 14-fold increase in China's holding since the start of the decade. As such, Dr Dollar's comment could be seen as signifying nothing. However, given his key role, it could also be seen as the smallest acknowledgement by the Treasury's emissary to China that a long-term shift in the US dollar's role is now under way.

Even without Dr Dollar's comments to spur on their thinking, China (and the other major reserve-accumulating nations) must surely have spent the summer months worrying about the outlook for the greenback. With the US unlikely to tighten monetary policy or exit emergency spending programmes at any point soon, there is relatively little that can be done to provide anything other than temporary support for the US dollar (indeed, this may go a long way towards explaining why secretary Geithner's comments on the US dollar are proving so infrequent). Equally, China no doubt realises that complaining too much about the US dollar in the circumstances could very well prove extremely self-defeating. Given this, in the short run China really has only one way out (in the absence of a slowdown of inflows): heightened reserve diversification.

#### CHINA TAKES ACTION?

Given this, it is interesting to note the number of commodity-related deals that Chinese companies have been involved in recent months. Possibly the key story was the news in late September that China's state-owned China National Offshore Oil Corporation (CNOOC) was bidding to gain control of a sixth of Nigeria's proven crude reserves from western oil groups. China had already been tying up a wide range of resource deals round Africa. However, as the *FT* noted, the CNOOC offer marked "a step change" in their quest in the continent.

#### KEY STATISTIC

■ **\$2,130bn**  
the size of China's foreign  
exchange reserves

China's interest was not confined to Africa. Elsewhere in the world, China Investment Corporation (CIC) bought an 11 per cent stake in Kazakhstan-based oil and gas company JSC KazMunaiGas, and a 14.5 per cent stake in the commodities shipping company Noble Group, as well as buying \$1.9bn of debt from PT Bumi Resources Tbk (Indonesia's biggest coal producer). Even major markets saw fresh interest out of China. In July, CIC acquired a 17 per cent stake in base metals miner Teck Resources of Vancouver (costing C\$1.74bn (\$1.64bn)), while in August PetroChina paid C\$1.9bn for a 60 per cent stake in two projects being planned by Athabasca Oil Sands Corp.

#### ACHIEVING A MEANINGFUL CONSENSUS

It is worth noting that even the G7 often struggled to reach a consensus on major intra member currency issues. Given recent history, it seems reasonable to presume that the G20 grouping will find it even harder. Put simply, it's difficult to see a G20 communiqué that would be prepared to directly criticise Chinese currency policy in the way that, say, the April 2007 G7 statement did. Instead, the risk must surely be that official commentary currency issues in

## There is relatively little that can be done to provide anything other than temporary support for the US dollar

the communiqués will be limited to anodyne warnings on the dangers of excessive volatility in the FX markets.

When the communiqué from the G20 leaders meeting in Pittsburgh was published in mid-September, it argued for the need to "establish a pattern of growth across countries that is more sustainable and balanced, and reduce development imbalances". One prerequisite of this is, of course, currency policies that help reduce global imbalances rather than exacerbate them. It remains to be seen whether G20, as the new premier forum for 'international economic cooperation', is capable of delivering on this need. **FT**

**Simon Derrick is head of currency strategy at BNY Mellon**

RESEARCHED AND PUBLISHED IN ASSOCIATION WITH

