

# G20: A CHANGE FOR THE BETTER?

By Simon Derrick, Head of Currency Research, BNY Mellon

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 in 2008, it was inconceivable that the major FX reserve holders (e.g. China) would not have a seat at the table when these matters were discussed. Although this move is certainly to be applauded, this new collaboration brings 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, and reaching agreement among key G20 members regarding the currency policy issues that have contributed to these imbalances has proved difficult.

It is worth noting that even G7 often struggled to reach a consensus on major intra member currency issues (as anyone who regularly picked over the bones of the communiqués can attest). 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 on currency issues will be limited to anodyne warnings on the dangers of excessive volatility in the FX markets.

There is an argument that says the key relationship within

G20 is that between the US and China, and that to truly understand the tensions within the group it is vital to understand the interplay between the two. It is therefore worth highlighting that China must surely have spent the summer months worrying about the outlook for the USD. However, 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 greenback. Equally, China no doubt realizes that complaining in these circumstances could simply prove self-defeating. Given this, in the short run China really has only one-way out: heightened reserve diversification.

Given this, it is interesting to note the number of commodity related deals that Chinese companies have been involved with in recent months (stretching from Kazakhstan to Canada). Equally, we note the comment from the head of Australia's debt agency that China is growing in importance as a buyer of Australia's sovereign bonds and (at the opposite

extreme) the report that China's Central Television, the main state-owned television company, has recently run a news programme letting the public know how easy it is to buy precious metals as an investment. All, in one way or another, allow China to diversify (albeit indirectly) its stock of USD-denominated currency reserves.

One prerequisite for reducing global imbalances is for the nations of G20 to follow a series of well-co-ordinated currency policies. Now that G7 has become G20, the risk is that centrally managed, coordinated change will prove even harder than it was before.

**Now that G7 has become G20, the risk is that centrally managed, coordinated change will prove even harder than it was before**

