

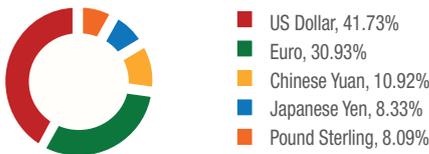
FLASH NOTE:

INTERNATIONALIZATION OF THE YUAN

THE INTERNATIONAL MONETARY FUND (IMF) RECOGNIZED THE CHINESE YUAN (CNY)¹ AS AN INTERNATIONAL CURRENCY, WHICH IS DEFINED BY BEING FREELY USABLE AND EXCHANGEABLE INTO ANOTHER CURRENCY WITHOUT DISADVANTAGE. RECENTLY, THE YUAN WAS INCLUDED IN THE IMF SPECIAL DRAWING RIGHTS (SDR) BASKET AS A FIFTH CURRENCY, ALONG WITH THE U.S. DOLLAR, EURO, JAPANESE YEN, AND POUND STERLING. THE DECISION WAS TAKEN BY THE IMF'S EXECUTIVE BOARD IN NOVEMBER 2015 AND TOOK PLACE IN OCTOBER 2016. THE YUAN'S INCLUSION IS NOT JUST AN IMPORTANT MILESTONE FOR CHINA, BUT ALSO FOR THE SDR ITSELF AS IT IS THE FIRST TIME FOR A NEW CURRENCY TO BE ADDED TO THE BASKET SINCE THE EURO REPLACED THE FRENCH FRANC AND THE DEUTSCHE MARK IN 1999. IN ADDITION, IT WILL HAVE A SIGNIFICANT EFFECT ON THE INTERNATIONAL FINANCIAL SYSTEM AND GLOBAL TRADE TRANSACTIONS.

NEW SDR BASKET WEIGHTS

- ▶ The IMF changed the weighting formula to better align basket weights with currencies' relative importance in international transactions. The following weights will be used to determine the amounts of each of the five currencies in the new SDR basket:



Source: International Monetary Fund

WHAT IS THE SDR?

- ▶ It is an international type of monetary reserve currency asset created by the IMF in 1969. Its value is based on a basket of five major currencies (US Dollar, Euro, Japanese Yen, Pound Sterling and Yuan).
- ▶ SDRs are a measure of a country's reserve assets with IMF. They are distributed among all member states of IMF in proportion to each member's quota of IMF dues.
- ▶ They also serve as unit of account of the IMF and some organizations like the Suez Canal Authority and Bank for International Settlements (BIS).
- ▶ Moreover, SDRs are used among governments and IMF for balance of payments settlements.
- ▶ The composition of the SDR basket is reviewed every five years to enhance the attractiveness of the SDR as a reserve asset

USD/CNY ²	EUR/CNY	CNY/JPY	GBP/CNY
=	=	=	=
6.77	7.44	15.48	8.29

THE SELECTION CRITERIA OF THE YUAN

The IMF agreed that the Yuan meets the two main criteria required for a currency to be included in the SDR basket as follows:

EXPORT ADVANCEMENT

- ▶ The SDR basket consists of currencies of IMF members or monetary unions whose exports had the largest value over a five-year period. Since 2010 review, China became the world largest trader in 2013, replacing the United States with total exports reaching USD2 trillion in 2015 contributing about 14% of global exports.



Source: World Trade Organization

¹ The official name of the Chinese currency is the Renminbi which means the people's currency

² Data is extracted from Thomson Reuters, as of the 1st of November 2016.



ALEXBANK | بنك الإسكندرية

A WORLD OF REAL POSSIBILITIES

www.alexbank.com
BANK OF INTESA SANPAOLO GROUP
INTESA SANPAOLO

Yuan is used in more than

100

countries to settle payments with China

Yuan is ranked

5th

as a global payments currency in value

Yuan is used in

8%

of global trade

FREE USAGE

- ▶ A freely usable currency is widely used for payments of international transactions and widely traded in the principal exchange markets. It is concerned with the actual international use and trading of currencies, and is different from whether a currency is either freely floating or fully convertible.
- ▶ For example, a currency could be subject to some government restrictions and still be widely used and traded.
- ▶ The freely usable concept seeks to ensure that a member can use the currency received from the IMF either directly or indirectly (by exchanging it into another currency without disadvantage) to address a balance of payments financing need.

IMPACT OF INTERNATIONALIZING THE YUAN

FOR CHINA

- ▶ The inclusion of the Yuan is expected to promote its internationalization where countries relying more on Chinese exports are expected to increase their holdings of Yuan to avoid currency mismatch. This would raise demand on the Yuan, leading to its appreciation over the long run. Moreover, the frequent use of the Yuan in international financial transactions makes it a potential third world reserve currency next to the EUR and USD.

FOR EGYPT

- ▶ Amidst the FX shortage Egypt is experiencing and the rise of the Chinese Yuan on global arena, Egypt has examined how it could benefit from the new status of the Yuan, specially that China ranked as the second trade partner to Egypt in FY 2015/16, with Chinese imports accounting for 8.4% of Egypt's total imports.
- ▶ Egypt has reached a currency swap agreement valued at USD2.7 billion with China. The agreement is currently being processed by the Chinese authorities, according to Bloomberg. Currency swap entails depositing a specific amount of money in Egyptian Pound in the People's Bank of China which in return deposits an equivalent amount in Yuan at the Central Bank of Egypt for a certain period.
- ▶ Through such proposed agreement, Egypt will be able to finance its imports from China using Yuan and China pays for its exports from Egypt using the Egyptian Pound, which can ease Egypt's currency problem by using the Yuan instead of the US dollar to finance imports coming from China.
- ▶ China signed similar 3-year currency swap agreements with a number of Arab countries like UAE (worth CNY35 billion) and Morocco (worth CNY10 billion). China renewed its existing agreements with the UAE in December 2015 for an additional period of three years.
- ▶ In the same context, the Suez Canal Authority recently adopted the Yuan among the approved currencies for payment of transit fees. Currently, the useable ten currencies are "US Dollar, Canadian Dollar, Japanese Yen, British Sterling Pound, Euro, Danish Krone, Norwegian Krone, Swiss Franc, Swedish Franc and the Chinese Yuan".



CONCLUSION

- ▶ Chinese Yuan is gaining more importance on the global arena with a rising role in international trade and global financial system, which urged the IMF to include it in the SDR basket of currencies.
- ▶ According to the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the Yuan is expected to play a greater role in international financial transactions, forecasting to account for 10% of the world's total reserves by 2025.
- ▶ China is trying to increase the global reach of the Yuan through signing strategic partnership agreements with different countries, removing the US dollar as an intermediate currency and launching direct trading using their local currencies (in the case of Saudi Arabia) and approving many currency swap agreements with other countries.
- ▶ Egypt is also trying to benefit from these developments through initiating partnership agreements with China, based on a larger presence of the Yuan in its external transactions and obtaining further support from China to help it face its worsening crisis.



ALEXBANK | بنك الإسكندرية

ALEXBANK  Research T: +2 02 2399 2000 E: research@alexbank.com

Head of Research
Emil Eskander

e: emil.eskander@alexbank.com

Research Manager
Hemat El Masry

e: hemat.elmasry@alexbank.com

Senior Associate:
Sahar Ezz El Arab

e: sahar.ezzelarab@alexbank.com

Researcher:
Nahla Abdel Azim

e: nahla.abdelazim@alexbank.com

© Copyright Notice. The Flash Note is a publication of ALEXBANK. No part of this publication may be reproduced or duplicated without the prior consent of ALEXBANK. This publication constitutes a summary of a major issue related to the Egyptian economy. This material does not constitute analytical economic research nor should be treated as such. All charts and graphs are from publicly available sources or proprietary data. Any views expressed in this publication do not necessarily reflect the opinion of ALEXBANK. The news, views and quotes within this publication are gathered from sources deemed to be reliable but which have not been independently verified. ALEXBANK does not make any guarantee to the accuracy or reliability of such information. AlexBank shall not be liable for any losses or damages incurred or suffered as a result of using its publications in part or in their entirety.