GLOBAL ECONOMIC OUTLOOK - AUGUST

2015

Monetary Department
External Economic Relations Division

CZECH NATIONAL BANK

Cut-off date for data
14 August 2015

CF survey date
10 August 2015

GEO publication date
21 August 2015

Notes to charts

ECB and Fed: midpoint of the range of forecasts.
The arrows in the GDP and inflation outlooks indicate the direction of revisions compared to the last GEO. If no arrow is shown, no new forecast is available. Asterisks indicate first published forecasts for given year.
Forecasts for EURIBOR and LIBOR rates are based on implied rates from interbank market yield curve (FRA rates are used from 4M to 15M and adjusted IRS rates for longer horizons). Forecasts for German and US government bond yields (10Y Bund and 10Y Treasury) are taken from CF.

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The August issue of Global Economic Outlook presents its regular overview of recent and expected developments in selected territories, focusing on key economic variables: inflation, GDP growth, leading indicators, interest rates, exchange rates and commodity prices. In this issue, we also focus our attention on the possible inclusion of the Chinese currency – the renminbi – in the SDR currency basket (the SDR is a monetary and accounting unit used by the International Monetary Fund). This autumn, the IMF will undertake its quinquennial review of the weighting scheme (and potentially also the composition) of the SDR basket, and the renminbi now qualifies for the basket thanks to the size of China's exports.

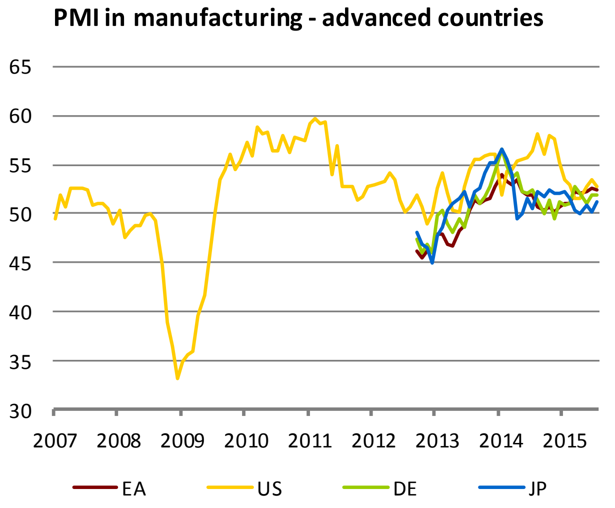
The GDP growth forecast for the euro area is little changed, with most of the monitored institutions agreeing on 1.5% for this year and a modest pick-up in 2016. So far, the growth has been driven mainly by household consumption, but the ECB's accommodative policy and a weaker euro are also expected to boost industrial production by the end of this year. A similar pattern – with even higher expected growth – can be seen for Germany. The US recovery is weaker than originally expected. As in the euro area, GDP growth is being driven by private consumption. However, the GDP growth outlook has been revised slightly downwards, as industry will be hampered by a strong dollar. The strong dollar will also reduce US inflation this year. Inflation in both the euro area and the USA should remain subdued this year, but increase above 1% next year and in the USA even approach the Fed's 2% target. The forecast for economic growth in Japan has been lowered for this year, but growth is still expected to accelerate in 2016.

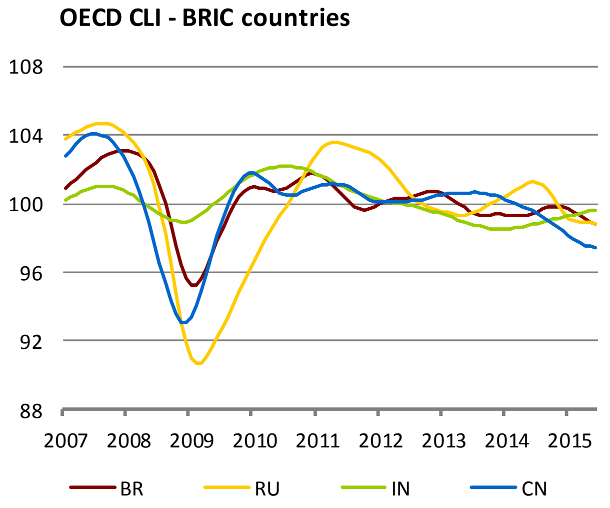
The expected economic developments in the BRIC countries are still mixed over the forecast horizon until 2016. The situation of the Indian economy can be assessed favourably, as inflation is falling despite easy monetary policy and the GDP growth outlook remains stable. The Chinese government is trying to prevent the expected economic slowdown by devaluing the renminbi. However, the GDP growth outlooks for this year have improved slightly and are unchanged for next year, the same as the expected low inflation. The situation is far worse in Russia, where the economic downturn is intensifying because of sanctions and a decline in oil prices. The Russian central bank is cutting interest rates despite high inflation. The outlook for the Brazilian economy is also worsening further owing to persisting political instability. Inflation in Brazil is rising as a result of depreciation of the real, even though the central bank is raising its interest rates.

The interest rate outlook is little changed. In the euro area, the 3M EURIBOR should stay at its current slightly negative levels at the one-year horizon owing to the ECB's continuing policy of quantitative easing. In the USA, by contrast, the implied paths of both short-term and long-term rates are rising sharply on expectations that the Fed will raise rates this year. The timing of this increase remains uncertain, however. According to CF, the US dollar will appreciate against virtually all the currencies under review at the one-year horizon, albeit only slightly (with the exception of the Brazilian real).

The oil price forecasts have been revised significantly downwards compared to the previous month owing to a sharp fall in prices in July and early August. This decline was a response to a persisting surplus of oil in the market and continuing growth in global stocks. The Brent crude oil price should thus be around USD 60 a barrel at the end of 2016. Natural gas prices based on long-term contracts normally lag behind oil prices by 6 to 9 months and are therefore expected to decrease further in the next few months below USD 200 per 1000 m^3. They should start rising again at the start of next year. The outlook for the non-energy commodity price index and its components is slightly rising for the rest of this year and broadly flat in 2016.

Leading indicators for countries monitored in the GEO

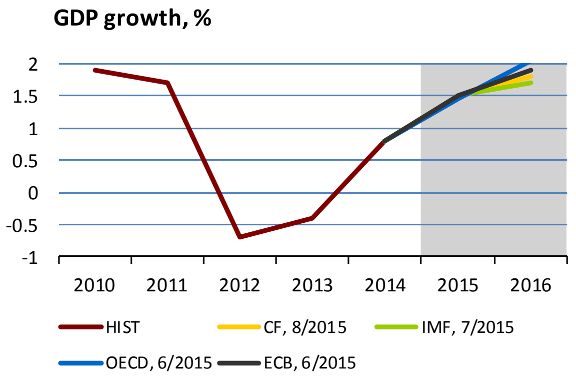




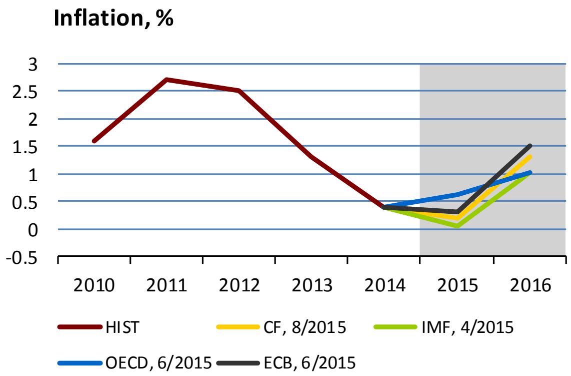
Zdroj: Bloomberg, Datastream

II.1 Eurozone

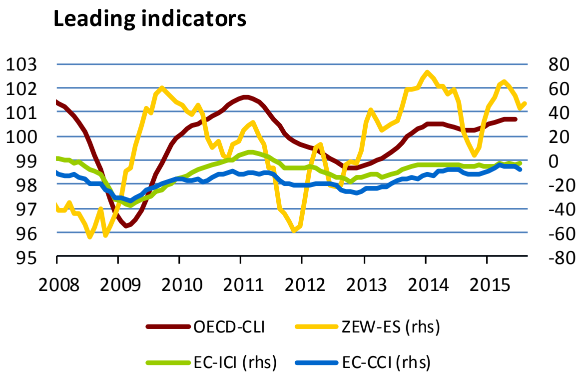
Most of the monitored institutions expect GDP to grow by 1.5% this year and accelerate by a further 0.4 pp in 2016. CF has long kept its growth forecast for this year and the next unchanged, while the IMF has increased its forecast for both years. Industrial production rose by 1.2% year on year in the first half of this year, which represents slight growth so far. Nonetheless, according to both CF and the PMI in manufacturing it will pick up pace by the end of the year. Real retail sales dropped month on month in June, but recorded solid annual growth in the first half of this year (2.1%). Household consumption is thus the main driving force of total GDP growth in the euro area. It accelerated to 1.2% year on year in 2015 Q2 (0.3% compared to Q1). The unemployment rate was flat for the third consecutive month, suggesting that economic growth is still too weak to have any major positive effect on the labour market. Consumer price inflation is expected to be very subdued just above zero. Consistent with this assumption is the actual July inflation, which was flat at 0.2% for the second month in a row. However, inflation is expected to increase above 1% in 2016. Inflation excluding energy and food prices, which rose to 1% in July, could be a positive signal in this regard. The 3M EURIBOR was slightly negative owing to the quantitative easing policy and is expected to stay there at the one-year horizon according to market outlooks. The 10Y German government bond yield fell to 0.6% in mid-August, but its one-year outlook remains rising.



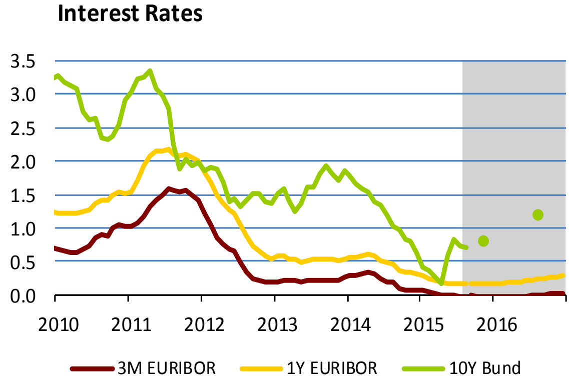
	CF	IMF	OECD	ECB
2015	1.5	1.5	1.4	1.5
2016	1.8	1.7	2.1	1.9



	CF	IMF	OECD	ECB
2015	0.2	0.1	0.6	0.3
2016	1.3	1.0	1.0	1.5



	OECD-CLI	EC-ICI	EC-CCI	ZEW-ES
5/15	100.7	-3.0	-5.6	61.2
6/15	100.7	-3.4	-5.6	53.7
7/15		-2.9	-7.1	42.7



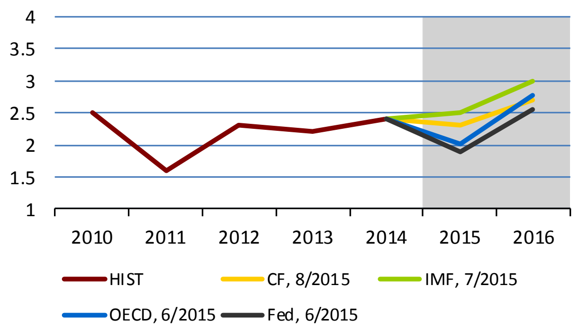
	07/15	08/15	11/15	08/16
EURIBOR 3M	-0.02	-0.02	-0.03	-0.01
EURIBOR 1R	0.17	0.16	0.17	0.23
Bund 10R	0.73	0.70	0.80	1.20

II.2 United States

According to the BEA advance estimate, the US economy accelerated to 2.3% in 2015 Q2 in annualised terms. The Q1 growth estimate was meanwhile revised from a slightly negative level to 0.6% following a revision of the estimated impacts of temporary factors (strikes at ports and weather fluctuations). Also revised were the estimates of growth rates in past years, based on which the economy grew at a lower pace on average (2.0%) in 2011–2014 (the original estimate had been 2.3%). The strength of the US economic recovery is thus lower than expected. The growth in 2015 Q2 was driven almost entirely by household consumption, supported by low oil prices and favourable labour market developments. Following negative contributions in the previous two quarters, the contribution of net exports was slightly positive despite a strong dollar. Leading indicators are favourable and are signalling a continued recovery, although the PMI in manufacturing, for example, fell slightly in July compared to June. The labour market is also improving further – total nonfarm payrols increased by 215,000 July and unemployment dropped to a seven-year low (5.3%). The growth rate of the economy for this year as a whole is expected to be similar to that recorded last year (2.0%–2.5%).

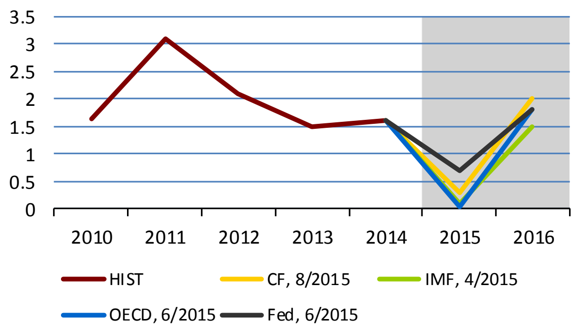
CPI inflation rose slightly to 0.2% in June. For this year as a whole it should be only slightly positive owing to low oil prices, a strong dollar and low wage growth. It should converge significantly towards the Fed's target next year. The Fed is expected to raise rates this year, but uncertainty surrounds the timing and speed of this increase. On the one hand are a relatively robust recovery and an improvement on the labour market. On the other are anti-inflationary pressures, which, given the uncertain situation in China, could strengthen owing to further appreciation of the dollar and falling commodity prices. The CF panellists expect the first increase in rates to happen at the September Fed meeting with a probability of 62.5%.

GDP growth, %



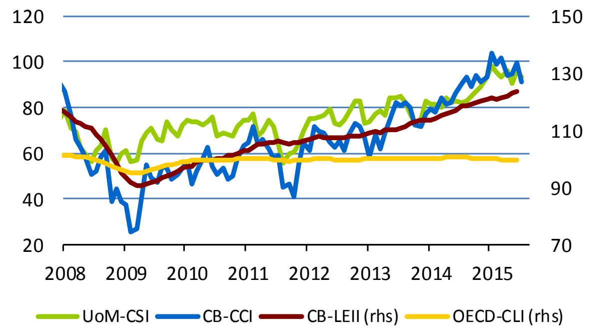
	CF	IMF	OECD	Fed
2015	2.3	2.5	2.0	1.9
2016	2.7	3.0	2.8	2.6

Inflation, %



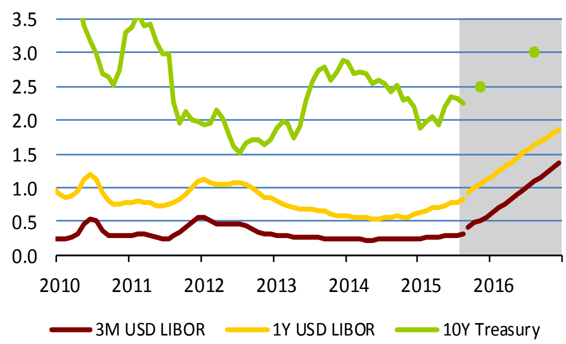
	CF	IMF	OECD	Fed
2015	0.3	0.1	0.0	0.7
2016	2.0	1.5	1.8	1.8

Leading indicators



	CB-LEII	OECD-CLI	UoM-CSI	CB-CCI
5/15	122.9	99.6	90.7	94.6
6/15	123.6	99.5	96.1	99.8
7/15			93.1	90.9

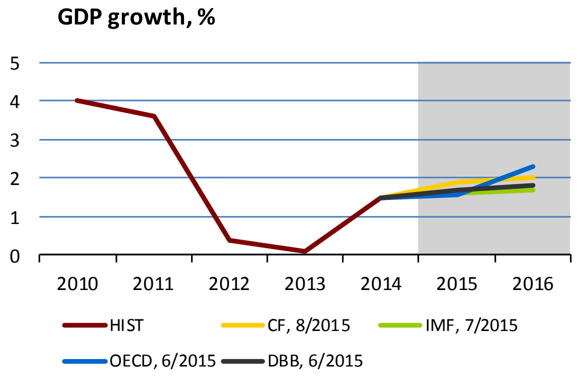
Interest Rates

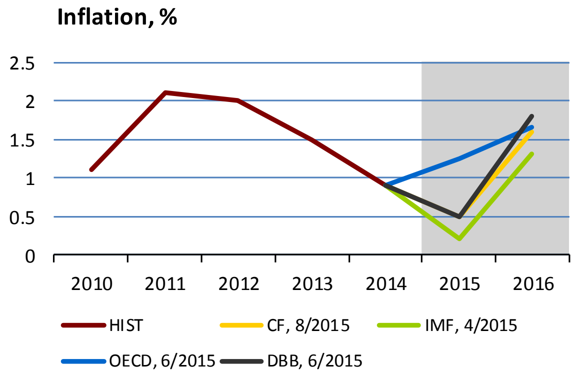


	07/15	08/15	11/15	08/16
USD LIBOR 3M	0.29	0.31	0.52	1.09
USD LIBOR 1R	0.79	0.79	1.05	1.63
Treasury 10R	2.32	2.25	2.50	3.00

II.3 Germany

In 2015 Q2, the quarterly growth rate of the German economy rose from 0.3% to 0.4% and the annual growth rate from 1% to 1.6%. Strong growth in domestic demand continued and was accompanied in this period by rising net exports to euro area countries. The August CF expects a further upturn in economic growth in Q3 and the second half of this year owing to strengthening domestic and external demand. The German economy should grow by 1.9% in 2015 as a whole and maintain approximately the same rate of growth in 2016. These expectations are confirmed by leading indicators, which remain at roughly above-average levels. German inflation dropped by a further 0.1 pp to 0.2% in July, mainly because of falling energy and food prices. According to the August CF, inflation should increase towards the end of this year and reach 0.5% on average for the entire year, rising to 1.6% in 2016.



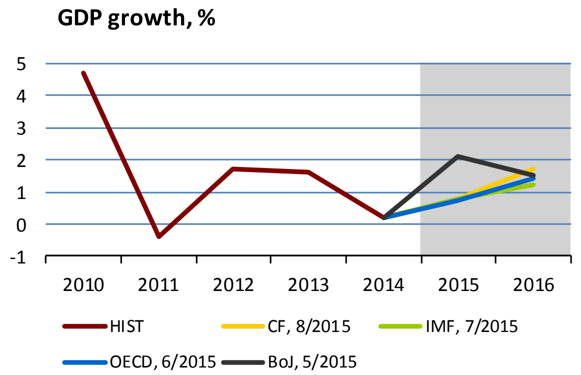


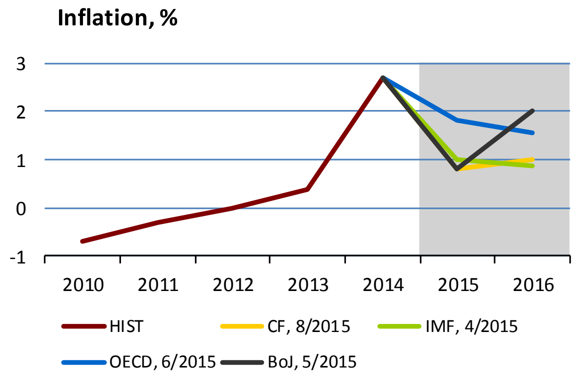
	CF	IMF	OECD	DBB
2015	1.9	1.6	1.6	1.7
2016	2.0	1.7	2.3	1.8

	CF	IMF	OECD	DBB
2015	0.5	0.2	1.2	0.5
2016	1.6	1.3	1.7	1.8

II.4 Japan

A number of leading indicators suggest that the Japanese economy will contract in Q2 after growing surprisingly in Q1. Annual growth in retail sales slowed below 1% in June, while household expenditure dropped by almost 1% year on year in the same period. However, the central bank expects a reversal in Q3 as steady wage growth feeds through to consumption. It is therefore putting further monetary stimuli on hold. On the other hand, the IMF warned of unsustainability of Japanese public debt, which is currently running at 245% of GDP. If the government fails to introduce stabilisation measures, the debt may reach treble the size of the domestic economy by 2030. In line with new data, both the August CF and the IMF decreased their outlooks for growth in 2015, whereas only the IMF revised its forecast for 2016. CF also lowered expected inflation for 2016 to 1%.





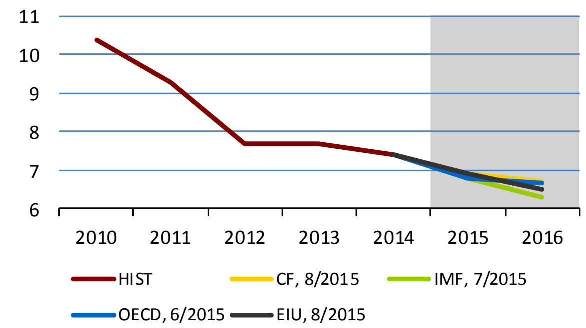
	CF	IMF	OECD	BoJ
2015	0.8	0.8	0.7	2.1
2016	1.7	1.2	1.4	1.5

	CF	IMF	OECD	BoJ
2015	0.8	1.0	1.8	0.8
2016	1.0	0.9	1.6	2.0

III.1 China

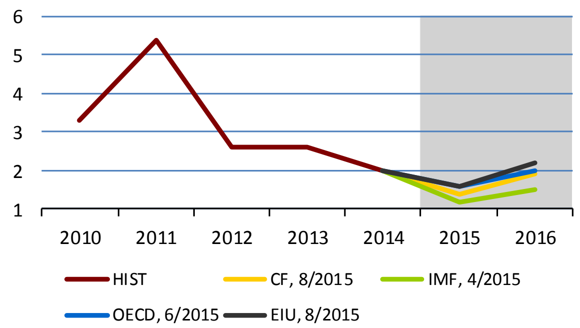
After attempts to stabilise the stock market stabilisation, the Chinese central bank devalued the renminbi reference rate by 1.9% on 11 August, the biggest weakening since January 1994. The renminbi continued to weaken the following day and thus lost 3.5% in two days, falling to its weakest level against the dollar since August 2011. The Chinese government is presenting the devaluation as a step towards greater flexibility of the renminbi. However, the weaker currency could boost exports, which are falling due to weak external demand (exports fell by 8% year on year in July). Although GDP growth was the same in Q2 as in Q1 (7%), it came as a positive surprise, especially in light of a decline in the PMI (to 47.8 in June) and a slowdown in industrial production to 6%. The new CF and EIU outlooks are slightly more optimistic. Their GDP growth outlooks for this year increased by 0.1 pp to 6.9%. The growth outlook for next year remained unchanged.

GDP growth, %



	CF		IMF		OECD	EIU	
2015	6.9	↗	6.8	↗	6.8	6.9	↗
2016	6.7	→	6.3	→	6.7	6.5	→

Inflation, %

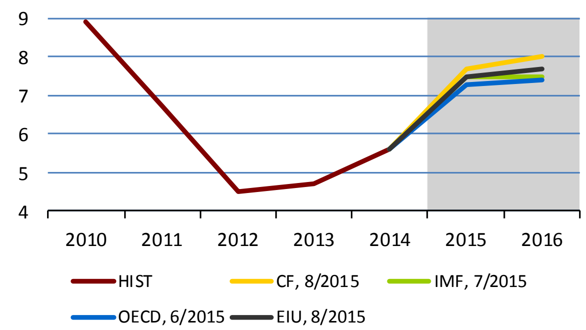


	CF		IMF	OECD	EIU	
2015	1.4	→	1.2	1.6	1.6	↗
2016	1.9	→	1.5	2.0	2.2	→

III.2 India

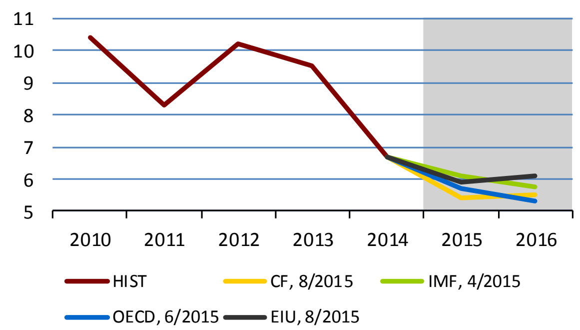
Inflation in India fell from 5.4% in June to 3.8% in July. In addition to base effects, this fall was due mainly to slowing food price growth, as concerns about a too weak monsoon have not materialised. The Indian central bank left interest rates unchanged at its last meeting. It is waiting for more marked transmission of its previous monetary policy easing. If inflation remains favourable in the coming months and the US interest rate hike is postponed, a further reduction in rates can be expected in the autumn. CF and the EIU left their inflation forecasts for this year at 5.4% and 5.9% respectively. Industrial production rose by 3.8% year on year in June and remains on a stable growth trend. The PMI in manufacturing is in the expansionary band and reached a six-month high in July. The CF and EIU outlooks for GDP growth remain unchanged.

GDP growth, %



	CF		IMF		OECD	EIU	
2015	7.7	→	7.5	↗	7.3	7.5	→
2016	8.0	→	7.5	↗	7.4	7.7	→

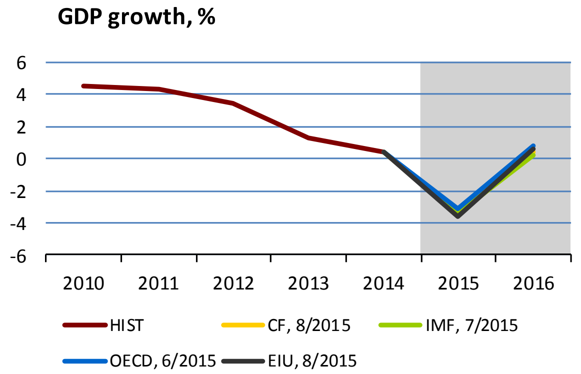
Inflation, %

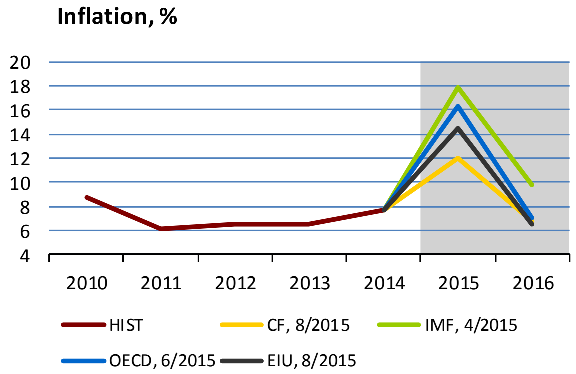


	CF		IMF	OECD	EIU	
2015	5.4	→	6.1	5.7	5.9	→
2016	5.5	↘	5.7	5.3	6.1	→

III.3 Russia

The economic contraction in Russia is accelerating. According to Rosstat's flash estimate, the decline in GDP deepened from 2.2% in 2015 Q1 to 4.6% in Q2. The country's economic growth has been slowed by sanctions for a year now. According to the IMF's model estimate, the initial impact of the sanctions (including retaliatory ones) was 1.0%–1.5% of GDP due to falling investment and consumption. If, however, the sanctions continue (so far they have been prolonged until August 2016), their cumulative effect on GDP in the medium term will be as much as 9% according to the IMF. The IMF's August GDP growth outlook is in line with the regular July WEO at -3.4% for 2015. The new CF and EIU outlooks expect GDP to fall by 3.5%–3.6% this year. The Russian central bank cut its key rate to 11% on 3 August. Inflation remains high, however, and will reach 12%–14.5% at the year-end according to the CF and EIU outlooks.



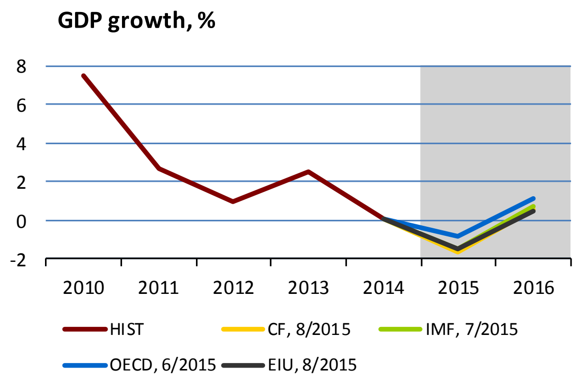


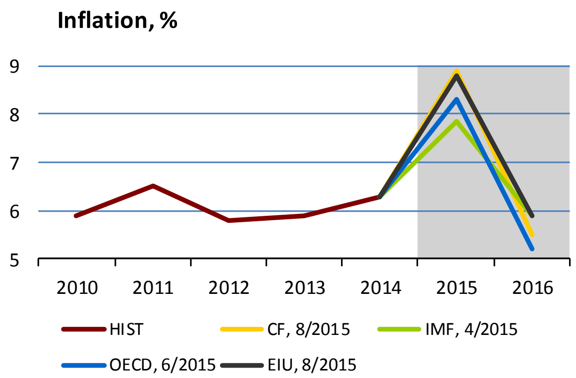
	CF	IMF	OECD	EIU
2015	-3.5	-3.4	-3.1	-3.6
2016	0.4	0.2	0.8	0.6

	CF	IMF	OECD	EIU
2015	12.0	17.9	16.3	14.5
2016	6.8	9.8	7.0	6.5

III.4 Brazil

The Brazilian economy is still showing worsening tendencies. Despite the central bank's best efforts, inflation is continuing to rise and reached 9.6% in July (8.9% in June). The Brazilian central bank is therefore continuing to raise its interest rates, which are currently at 14.25%. Both CF and the EIU increased their inflation outlooks for 2015 by 0.5 pp. Inflation is expected to return below 6% in 2016. Political instability in the country is increasing. The popularity of the president and her government is at an all-time low, making austerity measures much more difficult to implement. Standard & Poor's therefore downgraded its outlook for Brazil from stable to negative. Unemployment is rising, industrial production has been falling for a year and a half, the PMI in manufacturing remains in the contraction band and the Brazilian real has depreciated by 33% against the dollar this year. The economy is expected to contract by 1.5% this year and the estimates for next year have dropped to growth of just 0.5%.



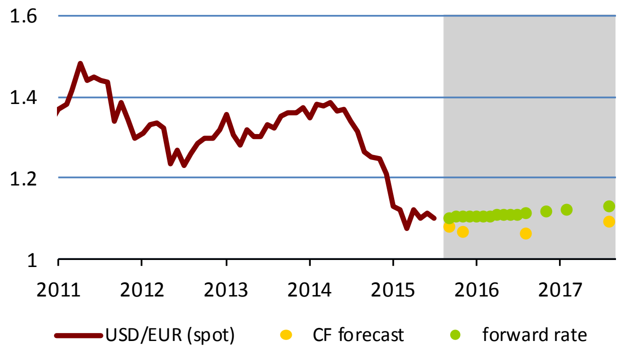


	CF	IMF	OECD	EIU
2015	-1.6	-1.5	-0.8	-1.5
2016	0.6	0.7	1.1	0.5

	CF	IMF	OECD	EIU
2015	8.9	7.8	8.3	8.8
2016	5.5	5.9	5.2	5.9

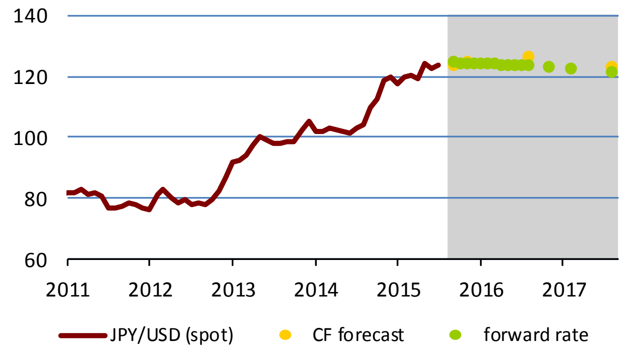
IV. Outlook of exchange rates vis-à-vis the US dollar

The euro



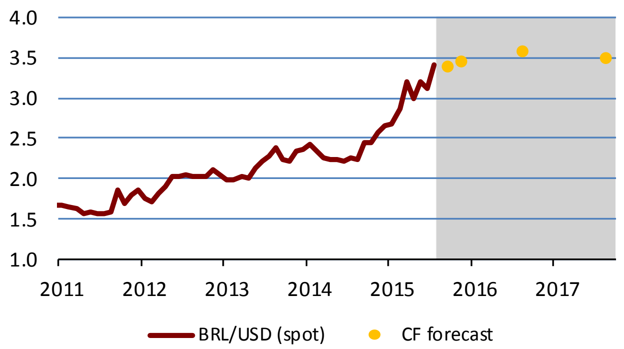
	10/8/15	09/15	11/15	08/16	08/17
spot rate	1.098				
CF forecast		1.078	1.066	1.061	1.094
forward rate		1.102	1.103	1.111	1.130

The Japanese yen



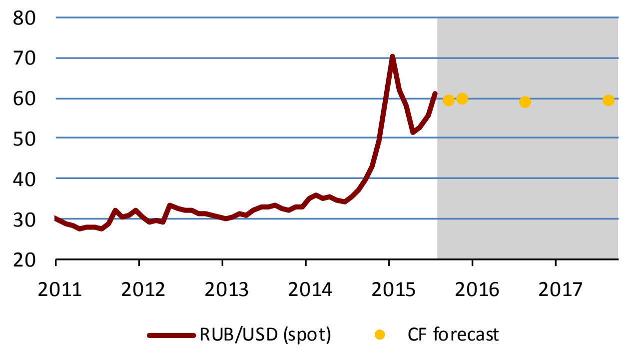
	10/8/15	09/15	11/15	08/16	08/17
spot rate	124.5				
CF forecast		123.8	125.0	126.6	123.1
forward rate		124.6	124.5	123.5	121.2

The Brazilian real



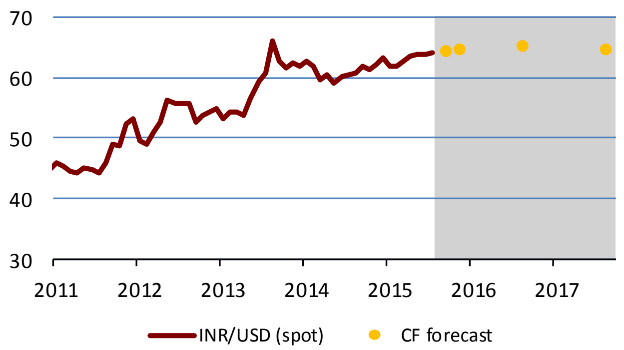
	10/8/15	09/15	11/15	08/16	08/17
spot rate	3.484				
CF forecast		3.381	3.447	3.579	3.497

The Russian rouble



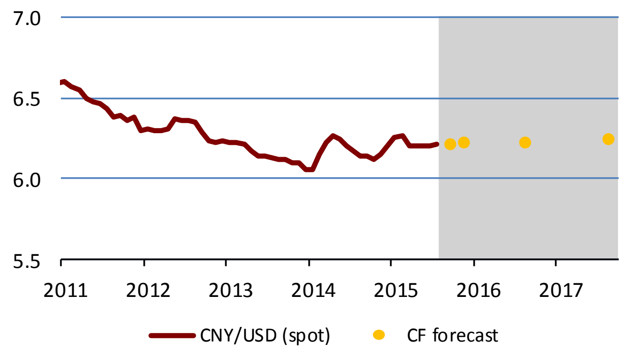
	10/8/15	09/15	11/15	08/16	08/17
spot rate	63.50				
CF forecast		59.46	59.71	58.82	59.52

The Indian rupie



	10/8/15	09/15	11/15	08/16	08/17
spot rate	63.86				
CF forecast		64.41	64.77	65.30	64.68

The Chinese renminbi



	10/8/15	09/15	11/15	08/16	08/17
spot rate	6.210				
CF forecast		6.214	6.220	6.223	6.243

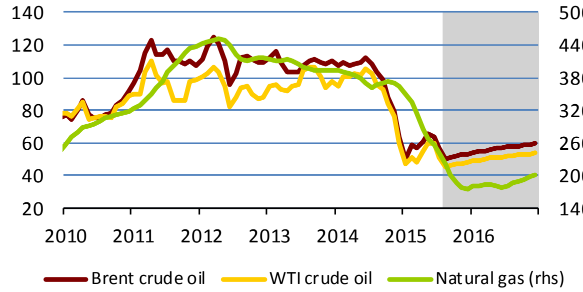
Exchange rates as of last day of month. Forward rate does not represent outlook; it is based on covered interest parity, i.e. currency of country with higher interest rate is depreciating. Forward rate represents current (as of cut-off date) possibility of hedging future exchange rate.

V.1 Oil and natural gas

The price of Brent crude oil fell by about 18% during July and that of WTI dropped even more sharply (by 21%). The slide continued into the first week of August and since then the Brent price has been below USD 50 a barrel (bbl). The WTI price also fell in the second week of August and was well below USD 45/bbl in the middle of the month. The main reason for the fall in oil prices is persisting growth in global stocks of oil and oil products due to excess supply. According to the IEA, growth in demand will reach a five-year high (1.6 million barrels a day) this year and above-average growth (of 1.4 million barrels a day) is also expected in 2016, with consumption supported by low prices. However, extraction remains high despite low oil prices and limited investment, thanks mainly to high production in OPEC countries. The WTI price is additionally under pressure from renewed growth in the drilling rig count in the USA and rising US stocks. The surplus of oil in the market is expected to fall gradually, but the IEA does not expect global oil stocks to decrease until the end of 2016. However, even this estimate may not materialise if extraction and exports of oil from Iran grow faster.

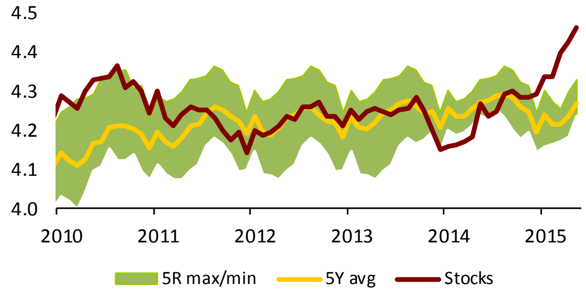
The oil price forecasts were revised strongly downwards compared to the previous month. The futures curve on 10 August implies an average Brent price of USD 56/bbl this year and just one dollar higher in 2016. The EIA expects an even lower price this year (USD 54/bbl) rising to USD 59/bbl in 2016. This means a downward revision of USD 6 and USD 8/bbl respectively. The WTI price is expected to be USD 5/bbl lower in both years. The CF forecasts have been higher for some time now; the August forecast expects Brent prices to rise to USD 56.9/bbl at three months and USD 63.8/bbl at one year horizon.

Outlook for prices of oil and natural gas (USD/1000m3)

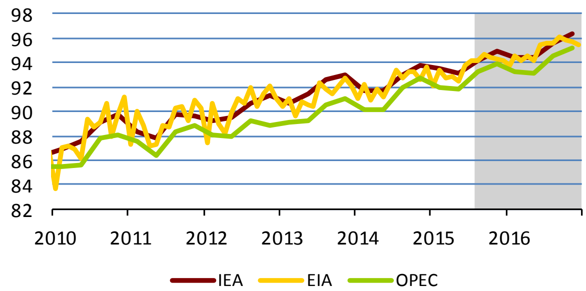


	Brent	WTI	Natural gas
2015	56.03	50.33	250.98
2016	56.97	51.46	185.95

Total stocks of oil and oil products in OECD (bil. barrel)

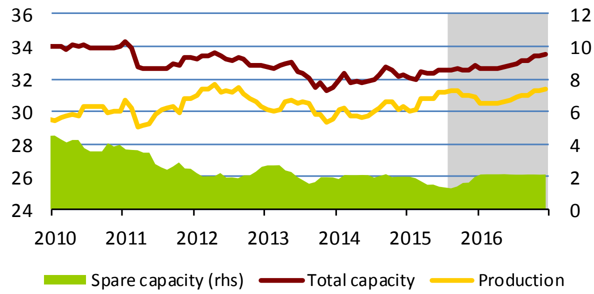


Global consumption of oil and oil products (mil. barrel / day)



	IEA	EIA	OPEC
2015	93.97	93.62	92.70
2016	95.18	95.08	

Production, total and spare capacity in OPEC countries (mil. barrel / day)



	Production	Total capacity	Spare capacity
2015	30.86	32.46	1.60
2016	30.83	32.96	2.13

Note: Oil price in USD/barrel, price of Russian natural gas at German border in USD/1,000 m3 (IMF data, smoothed by the HP filter). Future oil prices (grey area) are derived from futures and future gas prices are derived from oil prices using model. Total oil stocks (commercial and strategic) in OECD countries including average, maximum and minimum in past five years in billions of barrels. Global consumption of oil and oil products in millions of barrels a day. Production and extraction capacity of OPEC in million barrels a day (EIA estimate).

Source: Bloomberg, IEA, EIA, OPEC, CNB calculation

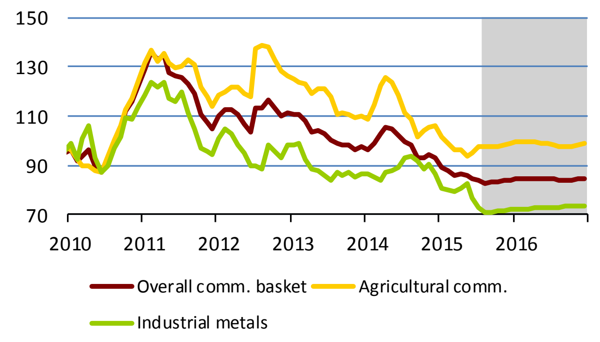
V.2 Other commodities

The average monthly non-energy commodity price index continued to fall in July and in the first half of August, mainly due to a broad-based decline in basic metal prices, which has outweighed a temporary increase in the food commodity price index. The outlook for all three indices is slightly rising in the rest of this year and broadly flat in 2016.

Basic metal prices continued to go down in July across the entire index. The decline has been going on since mid-May on concerns about slackening demand in China, where the PMI in manufacturing fell from 49.4 to 47.8 in July. Prices were also reduced by the strong dollar. The price of iron ore was unchanged in June following a previous increase thanks to a decline in global production (of 2.4% year on year in June). However, the price fell sharply again at the start of July due to persisting excess supply and a drop in global steel production in May. Metal prices could be supported going forward by stabilisation of the Chinese property market.

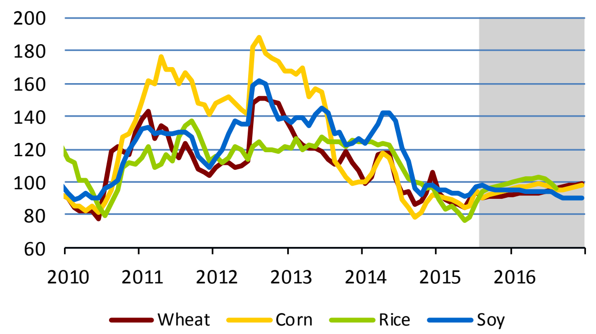
Prices of wheat, corn and soy rose sharply in the second half of June after the announcement of lower-than-expected stocks. Prices were also supported by colder and wetter weather in the major growing regions. However, prices dropped again in the second half of July as the weather improved and the dollar appreciated further. Only the price of rice maintained an upward trend. Prices of rubber have been falling for two and a half months due to rising stocks in China and falling oil prices.

Non-energy commodities price indicies



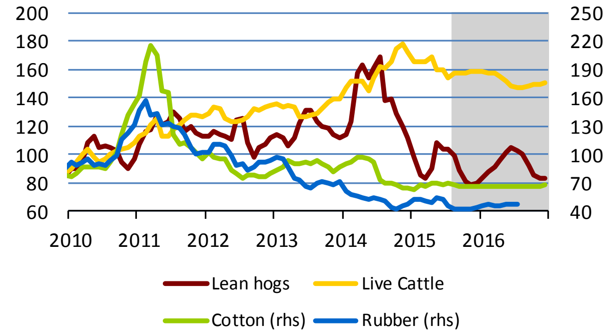
	Overall		Agricultural		Industrial	
2015	85.1	↘	97.6	↘	76.0	↘
2016	84.4	↘	98.7	↘	72.9	↘

Food commodities



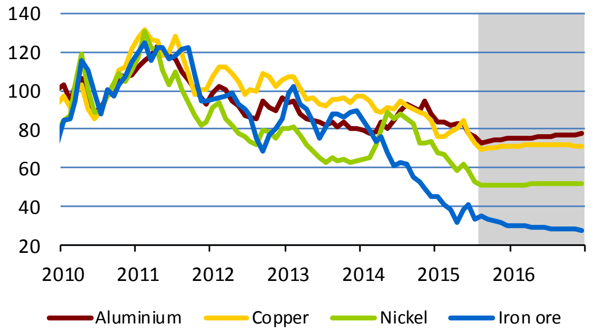
	Wheat		Corn		Rice		Soy	
2015	90.0	↘	90.8	↘	88.9	↗	94.6	↘
2016	95.1	↘	96.9	↘	100.5	↗	92.8	↘

Meat, non-food agricultural commodities



	Lean hogs		Live Cattle		Cotton		Rubber	
2015	91.7	↗	160.7	↘	67.3	↘	47.8	↘
2016	92.7	↗	151.8	↘	66.9	↘		

Basic metals and iron ore



	Aluminium		Copper		Nickel		Iron ore	
2015	78.3	↘	74.9	↘	57.1	↘	35.9	↗
2016	76.3	↘	71.6	↘	51.5	↘	28.8	↘

Note: Structure of non-energy commodity price indices corresponds to composition of The Economist commodity indices. All prices are given as indices, 2010 = 100 (charts) and percentage changes (tables).
Source: Bloomberg, CNB calculations.

The Chinese renminbi in the SDR basket: A realistic prospect?[1]

This autumn, the IMF will undertake its quinquennial review of the valuation of special drawing rights (SDR), i.e. its review of the SDR basket composition and weights. As in the previous review conducted in 2010, the debate will focus on the possible inclusion of the Chinese renminbi in the basket, as in the previous five-year period China met the first SDR entry criterion by becoming one of the four largest global exporters. The second criterion – that a currency be freely usable – is defined more loosely with recommended indicators. Our analysis reveals that despite having made clear progress in terms of international use, the renminbi cannot be considered an equal partner of the major currencies. There is no doubt, however, that it will attain such status in the years ahead. Membership of the SDR club would be acknowledgement of China's reform efforts in recent years and recognition of the global role of the Chinese economy.

1 SDR history and valuation principles

The SDR is the unit of account for IMF transactions and a supplementary reserve asset in the international financial system, as it represents a potential claim on the freely usable currencies of IMF members.

The SDR was created in 1969 as another form of reserve asset (in addition to gold and the US dollar) and unlimited international liquidity. Its value was initially set at SDR 35 per ounce of gold, at parity with the dollar. After the Bretton Woods system collapsed and floating exchange rates were introduced in 1974, a standard basket (with a fixed number of currency units) was adopted to ensure a stable value. A total of 16 currencies of countries each accounting for more than 1% of global trade in goods and services were selected. Despite a shortage of relevant data, the USA's share was increased ad hoc due to its major significance in financial transactions. In 1980, the number of currencies was reduced to five (USD, DEM, GBP, FRF, JPY) to make the basket more stable. The weights reflected the value of exports and the amount of foreign exchange reserves. Another adjustment was needed after the euro was introduced. As well as adding the new currency, the IMF made changes to the entire SDR valuation method in 2000.

The method now has three main elements:

- **Currency selection** – only the four currencies of the largest exporters (the first criterion – entry) whose currencies are freely usable (the second criterion).
- **Weights** – still derived from the size of exports and foreign exchange reserves.
- **Frequency** – the basket can still be reviewed at five-year intervals, although a review in the meantime is not ruled out.

The main change was the free usability criterion, which is intended to reflect the SDR's role as a supplementary reserve asset. The criterion of importance in global trade is a necessary but not sufficient condition for inclusion (Janáček and Komárek, 2013), as it reflects neither the currency's importance in international transactions nor the depth/breadth of its financial markets. A currency fulfilling the free usability criterion will have a benchmark rate, representative interest rate/hedging instruments and so on.

There are a number of broader SDR valuation principles aimed at enhancing the attractiveness of the SDR as a reserve asset. According to these principles, which are not stated in any decision of the IMF, the SDR's value should be stable in terms of the major currencies. The composition of the SDR currency basket should also be stable, and the SDR valuation method should be revised only as a result of major changes in roles of currencies in the world economy. This is reflected mainly in the discussions on how many currencies the basket should contain.

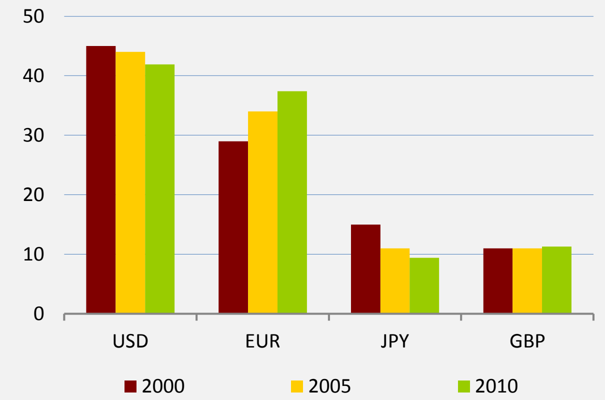


Figure 1 Changes in currency weights in the SDR basket in the last three reviews (in %).

Source: IMF

The last review of the valuation method, conducted in 2010, made only a slight change to the weights in favour of the euro (see Figure 1). However, the increase in China's trade prompted a discussion about changing the composition of the SDR currency basket. For the first time ever, China ranked among the four largest exporters over the entire five-year review period (2005–2009) and thus satisfied the criterion of importance in international trade.

[1] Written by Soňa Benecká (Sona.Benecka@cnb.cz). The views expressed in this article are those of the author and do not necessarily reflect the official position of the Czech National Bank.

However, based on a comprehensive assessment of the free usability criterion (using indicators and its own judgement) the IMF decided not to add the renminbi (RMB) to the currency basket for now. The inclusion of the RMB in the basket would have limited real impacts, but would recognise the Chinese economy's influence on the world economy and reflect the economic reforms implemented by China in recent years, and it would ultimately lead to the RMB being afforded reserve status. This new status would then further facilitate the international use of the RMB, which is the main goal of China's representatives. In the longer run, it would lead to a higher supply of safe assets. This supply has dropped in recent years because of the monetary policy measures introduced by central banks in advanced economies.

A new vote is expected to be held at the IMF this autumn. In the following section, we outline the arguments that might be heard during the meeting and analyse whether inclusion of the RMB in the SDR currency basket is a realistic prospect.

2 Changes in the composition of the SDR currency basket: Valuation criteria

The criterion of a freely usable currency has been of key importance for financial operations since the IMF was founded. As set out in Article XXX (f), a freely usable currency is a one that

- is widely used to make payments for international transactions and
- is widely traded in the principal exchange markets.

However, compliance with the conditions is not automatic, as an interpretation by the IMF is needed. Nor is there an exact list of indicators giving rise to an unambiguous assessment whether a currency is freely usable. In 2010, when the RMB was not included, three indicators were applied: international banking liabilities, international debt securities and global foreign exchange market turnover. The currency composition of foreign exchange reserves was also discussed. Let's now compare the RMB with the SDR basket currencies from the perspective of all these indicators over the last five years:

a) the currency composition of international banking liabilities and debt securities indicates which currencies are used in financial transactions. With regard to banking liabilities, it is important to distinguish whether they are denominated in domestic or foreign currency (see Figure 2). In both cases, however, the dollar and the euro dominate, followed by the pound and the yen. The same currency composition can be seen for international debt securities (see Figure 3). There is strong persistence in the currency preferences for financial transactions, although the euro area debt crisis boosted interest in the dollar as a transaction currency. For the RMB, we only have data on debt securities, whose share increased from zero in 2010 to 0.5% in the first quarter of 2015.

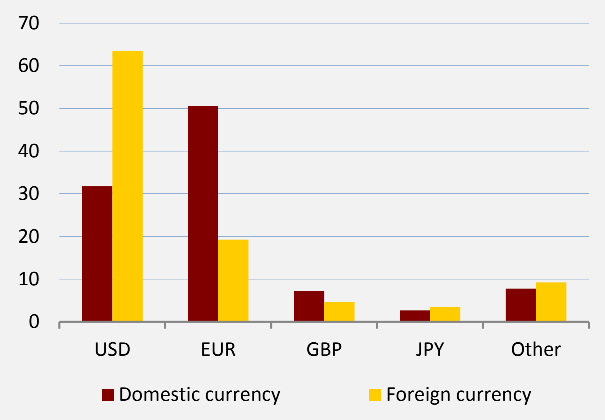


Figure 2 Currency composition of international banking liabilities (2010–2014 average, %)
Source: BIS, International Locational Banking Statistics

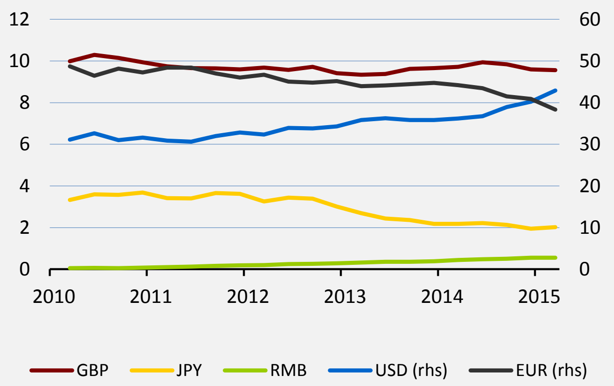


Figure 3 Currency composition of international debt securities (%)
Source: BIS, International Locational Banking Statistics

b) foreign exchange market turnover is a key indicator of how a currency is traded.[2] Figure 4 shows that more than 60% of the turnover on spot exchange rate markets is in the euro and the dollar. According to the latest BIS survey, conducted in 2013, the Chinese currency ranked ninth, accounting for more than 1% of total turnover. However, the RMB is not convertible on the onshore market. The RMB exchange rate regime since 2005 can be described as a managed float, with a clear trend of appreciation against the US dollar.

[2] The bid-ask spread also crops up in IMF documents. This indicator may reflect additional factors (liquidity conditions on financial markets), so we do not include it in the analysis.

c) the currency composition of foreign exchange reserves is an important indicator, but in this case we face a lack of data. We do not know the currency composition of almost half of total global reserves (particularly in the case of China). Allocated assets are dominated by the US dollar followed by the euro (see Figure 5). The pound and the yen each account for 3%. The Australian and Canadian dollars have also become more popular in recent years. The Chinese currency is not included in the core survey, but the Australian central bank, for example, has already invested more than 3% of its reserves in the RMB.

The debate about criteria was followed up with a special IMF document (IMF, 2011) proposing a new approach tailored to the reserve asset characteristics of the SDR. The reserve asset criterion is based on three key characteristics: liquidity in foreign exchange markets, hedgeability and availability of appropriate interest rate instruments in the relevant currency. Four indicators were proposed to assess these characteristics: currency composition of foreign exchange reserves, spot and derivatives market turnover and an appropriate market-based interest rate instrument. So, on top of the previous criterion, we now have derivatives market turnover (hedgeability) and the availability of investment instruments (interest rate risk manageability).

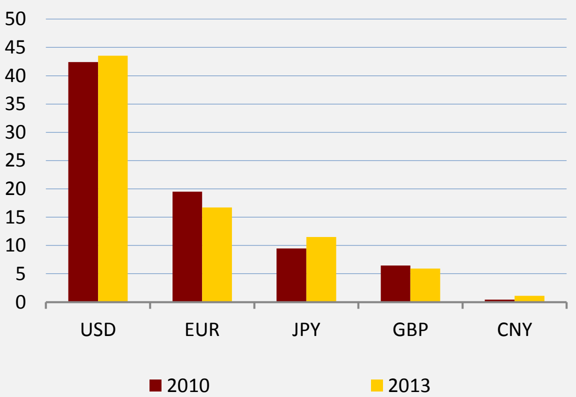


Figure 4 Shares in global spot foreign exchange market turnover in 2010 and 2013 (%)

Source: BIS, 2010 Triennial Central Bank Survey

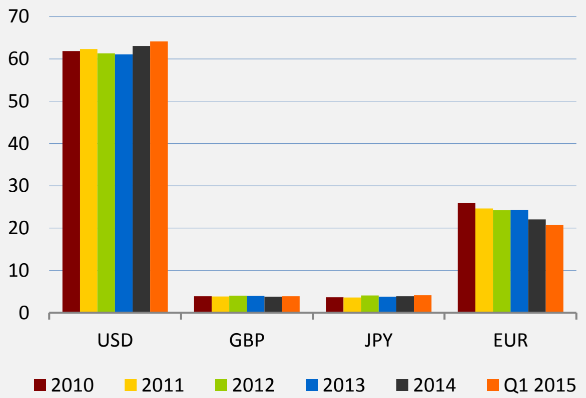


Figure 5 Currency composition of allocated foreign exchange reserves since 2010 (%)

Source: IMF, COFER

As regards the first indicator, Figure 6 shows that the derivatives market is dominated by instruments denominated in US dollars and other major currencies. The Chinese currency accounts for 2%–5% depending on instrument type, even lagging behind the Australian and Canadian dollars. The definition of the second criterion is very vague and does not specify how the criterion will be assessed. For comparison, see Figure 7 showing the size of debt markets (public and private). China currently has the fourth largest debt market in the world (USD 4.3 trillion), ahead of the United Kingdom. However, unlike advanced economies, China does not have fully liberalised capital flows, i.e. there is very limited access to onshore financial markets and a very limited ability to trade Chinese assets in the domestic currency. Foreign investors can invest directly in China under the Qualified Foreign Institutional Investor (QFII) programme, which offers quotas totalling USD 75 billion to 285 approved institutions. The offshore market, where deposits amounted to USD 440 billion and bonds to USD 77 billion at the end of 2014, is freely accessible. The amount of instruments available is very low overall.

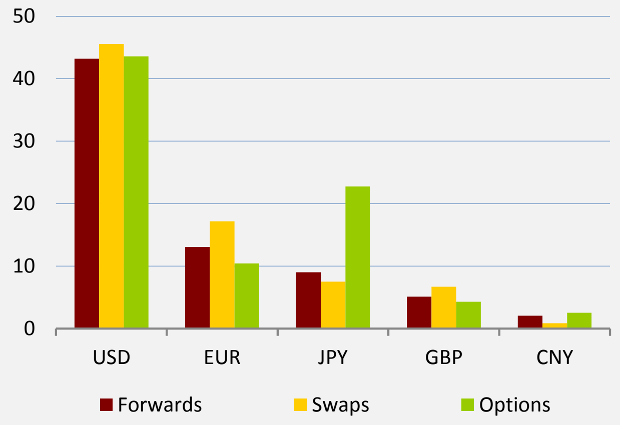


Figure 6 Shares in global derivatives foreign exchange market turnover in 2013 (%)

Source: BIS, 2010 Triennial Central Bank Survey

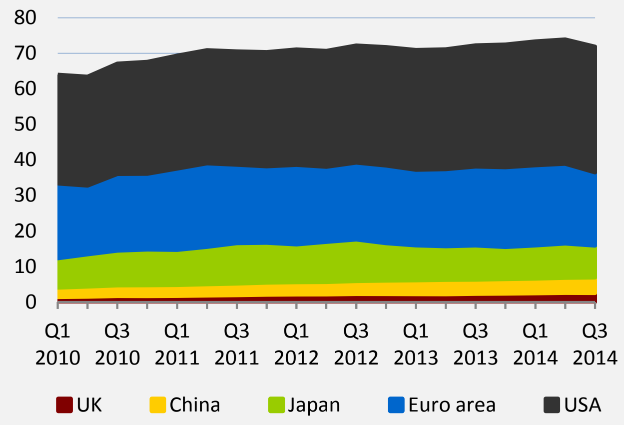


Figure 7 Size of debt markets in major advanced economies and China (USD trillions)

Source: BIS, International Locational Banking Statistics

Clearly, then, the RMB is neither widely traded in the principal foreign exchange markets nor used in financial transactions. On the other hand, it is increasingly being used in international trade in goods and services. According to SWIFT data, in May 2015 the Chinese currency ranked fifth among the currencies used for international payments, with a share of 2.2%. Unlike other currencies, RMB payments recorded year-on-year growth. The number of institutions using the RMB rose to 1,081 and a further rise can be expected after the China International Payment System is introduced at the end of this year. More than 27% of China's goods trade is now in the domestic currency and almost one-fifth of US firms have used or intend to use the RMB to make payments (according to HSBC). Under a new agreement, some payments to Russia for oil are now denominated directly in the RMB. According to estimates, more than 60 central banks have invested in the Chinese currency, with a total investment of USD 100 billion. This small amount indicates the willingness of central banks to test the new market and diversify their assets.

The reform efforts in China are not slackening, however. In a statement made in April, People's Bank of China Governor Zhou Xiaochuan presented a plan to make the RMB more freely usable, i.e. to attain managed convertibility of the currency, by deploying macroprudential measures (to a limited extent by the end of this year). In particular, China will:

- launch the pilot Qualified Domestic Individual Investor (QDII2) programme for cross-border investments by residents,
- introduce the Shenzhen-Hong Kong Stock Connect programme allowing non-residents to invest in China by issuing financial products,
- revise the foreign exchange market regulations to remove requirements for ex ante approvals, and build a system for ex post monitoring and macroprudential management,
- take measures to further facilitate access to the Chinese capital markets by overseas institutional investors,
- make efforts to further facilitate the international use of the RMB.

To sum up, from the point of view of the IMF's criteria the renminbi does not meet the requirements for inclusion in the SDR basket. So, if the IMF were to include the RMB in the SDR basket, it would be doing so more in recognition of the global role of the Chinese economy. This has happened before – the Japanese yen was included despite the fact that its currency did not become fully convertible until two years later (in 1980). However, the USA is likely to protest against any political interpretation even though the de facto peg of the RMB to the USD would increase the dollar's influence in the SDR basket.

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http://www.imf.org/external/spring/2015/imfc/statement/eng/chn.pdf

IMF (2011): Criteria for Broadening the SDR Currency Basket

IMF (2010): Review of the Method of Valuation of the SDR

A1. Change in GDP predictions for 2015

	CF		IMF		OECD		CB / EIU	
EA	0	2015/8 2015/7	+0.0	2015/7 2015/4	+0.0	2015/6 2015/3	0	2015/6 2015/3
US	-0.1	2015/8 2015/7	-0.6	2015/7 2015/4	-1.1	2015/6 2015/3	-0.6	2015/6 2015/3
DE	0	2015/8 2015/7	-0.0	2015/7 2015/4	-0.1	2015/6 2015/3	+0.7	2015/6 2014/12
JP	-0.2	2015/8 2015/7	-0.2	2015/7 2015/4	-0.3	2015/6 2015/3	0	2015/5 2015/1
BR	-0.2	2015/8 2015/7	-0.5	2015/7 2015/4	-2.3	2015/6 2014/11	0	2015/8 2015/7
RU	0	2015/8 2015/7	+0.4	2015/7 2015/4	-3.1	2015/6 2014/11	-0.1	2015/8 2015/7
IN	0	2015/8 2015/7	+0.0	2015/7 2015/4	+0.9	2015/6 2014/11	0	2015/8 2015/7
CN	+0.1	2015/8 2015/7	+0.0	2015/7 2015/4	-0.3	2015/6 2014/11	+0.1	2015/8 2015/7

A2. Change in inflation predictions for 2015

	CF		IMF		OECD		CB/EIU	
EA	0	2015/8 2015/7	-0.9	2015/4 2014/10	+0.0	2015/6 2014/11	+0.3	2015/6 2015/3
US	+0.1	2015/8 2015/7	-2.0	2015/4 2014/10	-1.4	2015/6 2014/11	0	2015/6 2015/3
DE	-0.1	2015/8 2015/7	-1.0	2015/4 2014/10	+0.0	2015/6 2014/11	-0.6	2015/6 2014/12
JP	0	2015/8 2015/7	-1.0	2015/4 2014/10	+0.0	2015/6 2014/11	-0.2	2015/5 2015/1
BR	+0.5	2015/8 2015/7	+2.0	2015/4 2014/10	+2.9	2015/6 2014/11	+0.5	2015/8 2015/7
RU	-0.1	2015/8 2015/7	+10.6	2015/4 2014/10	+8.6	2015/6 2014/11	-0.3	2015/8 2015/7
IN	0	2015/8 2015/7	-1.4	2015/4 2014/10	-0.7	2015/6 2014/11	0	2015/8 2015/7
CN	0	2015/8 2015/7	-1.3	2015/4 2014/10	-1.0	2015/6 2014/11	+0.1	2015/8 2015/7

A3. List of abbreviations

ABS	asset-backed securities
BoJ	Bank of Japan
BR	Brazil
BRIC	countries of Brazil, Russia, India and China
BRL	brazilian real
CB-CCI	Conference Board Consumer Confidence Index
CB-LEII	Conference Board Leading Economic Indicator Index
CBOT	Chicago Board of Trade
CBR	Central Bank of Russia
CF	Consensus Forecasts
CN	China
CNB	Czech National Bank
CNY	Chinese renminbi
DBB	Deutsche Bundesbank
DE	Germany
EA	euro area
EC	European Commission
ECB	European Central Bank
EC-CCI	European Commission Consumer Confidence Indicator
EC-ICI	European Commission Industrial Confidence Indicator
EIA	Energy Information Administration
EIU	Economist Intelligence Unit
EIU	The Economist Intelligence Unit database
EU	European Union
EUR	the euro
EURIBOR	Euro Interbank Offered Rate
Fed	Federal Reserve System (the US central bank)
FRA	forward rate agreement
GBP	pound sterling
GDP	gross domestic product
HICP	harmonised index of consumer prices
CHF	Swiss franc
ICE	Intercontinental Exchange
IFO	Institute for Economic Research
IFO-BE	IFO Business Expectations
IMF	International Monetary Fund
IN	India
INR	Indian rupee
IRS	Interest Rate swap
JP	Japan
JPY	Japanese yen
LI	leading indicators
LIBOR	London Interbank Offered Rate
MER	Ministry of Economic Development (of Russia)
OECD	Organisation for Economic Co-operation and Development
OECD-CLI	OECD Composite Leading Indicator
PMI	Purchasing Managers' Index
PPI	producer price index
RU	Russia
RUB	Russian rouble
TLTRO	targeted longer-term refinancing operations
UoM	University of Michigan
UoM-CSI	University of Michigan Consumer Sentiment Index
US	United States
USD	US dollar
WEO	World Economic Outlook
WTI	West Texas Intermediate (crude oil used as a benchmark in oil pricing)
ZEW-ES	ZEW Economic Sentiment
ABS	asset-backed securities

A4. List of thematic articles published in the GEO

2015

	Issue
The Chinese renminbi in the SDR basket: A realistic prospect? (Soňa Benecká)	2015-8
Annual assessment of the forecasts included in GEO (Filip Novoný)	2015-7
Seasonal price movements in the commodity markets (Martin Motl)	2015-6
Assessment of the effects of quantitative easing in the USA (Filip Novoný)	2015-5
How consensus has evolved in Consensus Forecasts (Tomáš Adam and Jan Hošek)	2015-4
The US dollar's position in the global financial system	2015-3
The crisis and post-crisis experience with Swiss franc loans outside Switzerland (Alexis Derviz)	2015-2
The effect of oil prices on inflation from a GVAR model perspective (Soňa Benecká and Jan Hošek)	2015-1

2014

	Issue
Applicability of Okun's law to OECD countries and other economies (Oxana Babecká Kucharčuková and Luboš Komárek)	2014-12
Monetary policy normalisation in the USA (Soňa Benecká)	2014-11
Changes in FDI inflows and FDI returns in the Czech Republic and Central European countries (Vladimír Žďárský)	2014-10
Competitiveness and export growth in selected Central European countries (Oxana Babecká Kucharčuková)	2014-9
Developments and the structure of part-time employment by European comparison (Eva Hromádková)	2014-8
The future of natural gas (Jan Hošek)	2014-7
Annual assessment of the forecasts included in GEO (Filip Novoný)	2014-6
How far the V4 countries are from Austria: A detailed look using CPLs (Václav Žďárek)	2014-5
Heterogeneity of financial conditions in euro area countries (Tomáš Adam)	2014-4
The impacts of the financial crisis on price levels in Visegrad Group countries (Václav Žďárek)	2014-3
Is the threat of deflation real? (Soňa Benecká and Luboš Komárek)	2014-2
Forward guidance – another central bank instrument? (Milan Klíma and Luboš Komárek)	2014-1

2013

	Issue
Financialisation of commodities and the structure of participants on commodity futures markets (Martin Motl)	2013-12
The internationalisation of the renminbi (Soňa Benecká)	2013-11
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