

Turbulent transition for Crisis Quintet

The five SDR currencies face strains and tribulations

The big question regarding the multicurrency system into which the world is slowly moving is whether this will be more or less stable than the previous set-up. A de facto duopoly has occupied the world monetary centre stage for the past 80 years – first, sterling and the dollar (up to 1945); then the dollar and sterling (1945-76); the dollar and the D-mark (1976-99); and, since 1999, the dollar and the euro.

In 2016, nominated by OMFIF as ‘The Year of the Multicurrency System’, the world passed a landmark with the entry of the renminbi on 1 October into the International Monetary Fund’s special drawing right. This confirmed the new circumstances in which a still-dominant dollar shares its role with several other international currencies. OMFIF said then, ‘It seems we are heading for a turbulent transition.’ All five of the SDR constituents – which could be called ‘the quintet of crisis’, the dollar, euro, sterling, yen and renminbi – are subject to their own inherent strains and tribulations.

As currencies jostle for position, the greatest potential for shock stems from America. As Meghnad Desai pointed out in his July report ‘The political economy of Donald Trump’, the president-elect has an unorthodox policy on debt: ‘As a businessman who has amassed a fortune, he views debt not as a burden but as a tool for doing business.’ This is just one of the reasons why the dollar may experience a see-saw ride. The authorities behind the renminbi are still learning the rudiments of running an international currency – and this brings much room for upset. Storm clouds are amassing over the euro. Italy’s referendum risks breaking the euro area’s weakest link. The yen is prone to setbacks as the Bank of Japan’s drawn out monetary experiment with massive quantitative easing runs its course. And sterling, up to mid-year the most stable member of the SDR bloc after the dollar, has fallen after the referendum decision to leave the European Union.



TRUMPONOMICS AND BREXIT – HEMRAZ JANKEE

Monetary policy divergence set to re-emerge

The British EU referendum and the election of Donald Trump have been two of the most significant episodes in 2016, both greatly affecting values of sterling and the dollar, two premier constituents of the special drawing right. Like other features of 2016, such as the rise of populist parties in Europe, these upsets reveal the size of the divide between the haves and the have-nots, and highlight a rise in nationalism in the West. This may not augur well for future political developments. With the US Federal Reserve Board gearing up for interest rate hikes, divergence in major central banks’ monetary policies may emerge in the new economic environment. Sterling, too, will be affected by the dollar’s buoyancy. Brexit and Trumponomics have indeed clouded the future.



GLOBAL TRADE SLOWDOWN – ELLIOT HENTOV

Deglobalisation trend raises doubts over UK position

Oxford Dictionaries chose ‘post-truth’ as the word of the year, but ‘post-trade’ would have been equally valid; 2016 was the first non-recession year on record where world merchandise trade grew more slowly than world GDP. The number of protectionist measures introduced in 2016 is nearly four times as high as the 2008-13 average, the strongest sign yet of deglobalisation. The defining contrast between the US election and Britain’s referendum was that Brexiteers claimed EU withdrawal would boost trading opportunities. However, the drama around the Canada-EU trade agreement and the expected demise of the Trans-Pacific Partnership and Transatlantic Trade and Investment Partnership should raise concerns about whether the UK can improve trading networks outside the EU.



RENMINBI INTERNATIONALISATION – GAO HAIHONG

IMF SDR move confirms China currency reserve status

China regards the new SDR basket comprising the dollar, euro, renminbi, yen and sterling as a fresh start for Beijing as well as its foreign partners, enshrining the principle of multilateralism at the heart of the world financial system. Actions by the People’s Bank of China and growing use of the interbank bond market reflect China’s vision of the SDR as an important part of global investment diversification. This accompanies a new phase in renminbi internationalisation: with reserve currency status now confirmed by the IMF, the renminbi is expected to make further inroads into world foreign exchange reserves, and trade and financial transactions. Alongside these developments, China is expected to continue to open up its financial markets and carry out reforms in a sustainable manner.



MERKEL AND THE EURO – DAVID MARSH

German chancellor strengthened by international squalls

Angela Merkel, the German chancellor, has had a difficult 12 months, losing popularity over her controversial policies of welcoming refugees from trouble spots abroad, and suffering a series of reverses in state elections. Yet she has emerged strengthened. She can be expected to be buoyed by an intrinsic German wish for stability in the face of geopolitical uncertainties caused by the impending British EU exit and the election of Donald Trump. More than ever, Merkel has emerged as the most important factor of stability behind the European single currency, which – unusually for the past five years – has survived 2016 without a major crisis, but where basic tensions between credit and debtor countries remain unresolved.



CURRENCY VOLATILITY – LINDA YUEH

Renminbi's rising importance adds to fluctuations

This year has seen exchange rate volatility rise to the forefront of macroeconomic policy anxieties, with the renminbi as a top concern. Now that the interest rate has been liberalised, the renminbi is beginning to find its footing, helped by a stabilising current account balance. Monetary easing by the European Central Bank and Bank of Japan has continued at a time when US interest rates are starting to normalise. Such divergence is mirrored in economies with exchange rate pegs, adding to global volatility. The renminbi's rising importance introduces a new currency risk to be managed – even though the tools to do so are in short supply. At a time of divergent monetary conditions and uncertainties induced by Chinese reforms, currencies are likely to remain volatile.



ONE BELT, ONE ROAD – YASEEN ANWAR

Chance for renminbi-related investments across Eurasia

The entry of the renminbi into the SDR basket, and China's \$1.8tn 'One Belt, One Road' initiative to build wide-ranging transport and infrastructure links with its neighbours and across Eurasia, represent an excellent opportunity for policy-makers to incorporate China's currency into their core economic strategies. This could serve the interests both of revitalising economic and trading links in many of China's partners, and of helping to achieve desired global stability. Much work remains in developing China's capital markets. But with the current fast pace work in progress for the capital markets, the combination of a more market oriented renminbi and OBOR represents an opportunity for investors to incorporate Chinese and related Eurasian projects into their long-term portfolios.



LOW-CARBON TECHNOLOGY – NICK BUTLER

China, US will compete for environmental leadership

The December 2015 Paris Agreement and the understanding reached between China and the US on climate change risk being overshadowed by Donald Trump's election. It is too early to tell how serious his climate change beliefs are. He will no doubt relieve some of the pressures on the US coal industry, and seems unlikely to push decarbonisation. Fortunately for environmentalists, the understanding between China and the US was reached on the basis of science. China's embrace of clean technology is serious and is linked to their desire to sell that technology in exports. The most likely outcome is that both countries will compete for industrial leadership in low carbon technology – not a bad outcome for the world.



INDIA'S DEMONETISATION DRIVE – MEGHNAD DESAI

Modi risks unpopularity to drive radical reform

On 8 November, Prime Minister Narendra Modi announced a radical demonetisation plan for India to combat 'black money'. There are fears that the resulting chaos could slow the economy or reduce its rate of growth, but after the initial shock, there will probably be a negligible impact on national income. If India can be weaned off hard cash in favour of plastic, this will lead to a considerable reduction in transaction costs as well as less corruption. Banks inundated with cash deposits will have to cut lending rates, which will reduce the liabilities of the central bank and can be a dividend to be shared with the government. This bold step shows Modi's willingness to risk unpopularity for radical reform. In due course, this will strengthen the rupee's credentials as an international currency.



ISIS TERRORIST MOVEMENT – FRANÇOIS HEISBOURG

Jihadism prospers, despite dismantling of territorial base

One notable development in 2016 was the dismantling of the territorial base of Isis. This is unlikely to prevent a repetition of this year's terror attacks in Brussels, Istanbul or Nice, although it is undoubtedly good news for the inhabitants of Mosul or Raqqa. Such attacks on foreign soil were supported and encouraged by Isis, but mainly executed by home-grown operatives. Mounting losses of territory for Isis mean foreign terrorists trained in the Middle East may now return to their countries of origin. Increasingly deadly jihadi groups in Pakistan and Bangladesh will continue to threaten the Indian subcontinent. As Isis weakens, a rebranded Al Qaeda is likely to recover. It may have been a bad year for Isis as a quasi-state, but jihadism more broadly is doing all too well.



POWER OF COMMUNICATION – ANTONIO ARMELLINI

Chain of dislocation: from Arabia to the US

The world has seen the collapse of the post-first world war order in the Arabian Peninsula and the demise of Kemalism in Turkey, as well as the rise of 'ummah' or supranational Islamic community as a rediscovered element of revolutionary identity. A further element of dislocation has been the apparent demise of the universal paradigm of liberal democracy, underlined by Donald Trump's extraordinary win. He proved successful in using communication that was designed to make democracy more effective to spread a message that could undermine it. Trump may well decide to go down the road of repression, but what will ultimately win the day is communication capable of exposing contradictions and providing an alternative route to stability.



BRITAIN'S EU WITHDRAWAL – DENIS MACSHANE

UK must rule on visas and work permits

Brexit is the most important development in the history of European co-operation since the European Coal and Steel Community was created in 1950. It has cost the career of a prime minister and brought a second woman leader to No.10. The UK must decide whether or not to go for a total rupture, meaning no more single market, no more customs union, and and withdrawal from other areas of co-operation under EU rules like Erasmus, university funding or the European Arrest Warrant. After years of promoting visa-free travel, Britain looks likely to start imposing visas, work permits and residence permits. There was no preparation for Brexit. It is a massive undertaking for the civil service. Years of political uncertainty stretch ahead.



UK OPPORTUNITIES – GERARD LYONS

Britain can prosper outside EU

The financial Armageddon in the UK that was widely predicted after the referendum decision has not occurred. The British economy has shown resilience and continues to attract inward investment. London will remain the EU's, and one of the world's, leading global financial centres. It is possible that the economy could slow temporarily in the next 12-24 months. Despite this, detailed research shows that leaving the EU and taking a global approach produces higher growth and more employment than remaining in an unreformed union. Brexit is likely to produce a significant economic gain. The UK does not need to be in the single market to have access to it, while being outside returns control over laws and borders and frees the UK from EU regulations and its external tariff.



MICHEL TEMER'S GOVERNMENT – OTAVIANO CANUTO

Brazil plagued by fiscal imbalances and low productivity

Brazil's post-impeachment government of President Michel Temer must reverse the deepest economic contraction in the country's recent history. GDP per capita this year is more than 10% lower than three years ago. Unemployment exceeds 11%, four percentage points higher than in January 2015. Economic recovery hinges on business confidence, which will depend on government measures dealing with structural problems. No fiscal or monetary space is available for counter-cyclical policies. The economic difficulties stem from long-standing vulnerabilities that have intensified in the last few years, particularly fiscal imbalance and anaemic productivity – a 'double malaise' plaguing the Brazilian economy.



GROWTH IN SPAIN – JOSÉ MANUEL GONZÁLEZ-PÁRAMO

Madrid chance to overcome political gridlock

The Spanish economy will grow 3.3% in 2016, double the European average. This reflects the general European benefits of lower interest rates, a weaker euro and lower oil prices; in addition Spain has gained from recent economic reforms. Political uncertainty throughout 2016 has held back potential growth, but, now that Spain has a chance of overcoming its political gridlock, it will need to reduce imbalances accumulated over the past years and discover a new dynamic of employment and productivity. To achieve this quickly, Spain must adopt reforms to realise three goals: reducing the public deficit while ensuring pensions sustainability, tackling high unemployment, and fostering inclusive growth through higher productivity.



PANAMA PAPERS – VICKY PRYCE

Clampdown on offshore financial centres

In April 2016 the world was shaken by the leak of some 11.5m files from the database of Mossack Fonseca, the Panama-based law firm which, among other things, incorporates companies in offshore jurisdictions. The media exposure revealed widespread use of offshore structures by individuals, their families and associates to reduce tax liabilities, including scores of senior politicians and heads of states. It raised serious questions about the functioning of and justification for offshore financial centres, including the way they encourage tax avoidance and evasion, as well as their help in shielding many corporations and individuals by specially devised anonymous structures which may be hiding illegal activities. The result is an extended effort to clamp down on offshore centres.

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