REMARKS BY MR. JAVIER GUZMÁN CALAFELL, DEPUTY GOVERNOR AT THE BANCO DE MÉXICO, AT THE OMFIF-RAMP DISCUSSION ON "NAVIGATING THE MULTICURRENCY RESERVE ENVIRONMENT", Washington, DC, 6 October 2016. [1]

Let me start by expressing my appreciation to the organizers for the invitation to participate in this panel.

In recent years, central banks around the world have shown an increasing interest in investing their international reserves in assets denominated in a wider array of currencies. This is explained by a number of reasons, including a more active search for yield in a low interest rate environment and diversification from a risk management perspective.

To what extent is this leading to a multicurrency environment?

There are a number of attributes that a currency needs to fulfill to reach international status and take on a significant global role. First and foremost, it must be seen as a reliable store of value by both private and official non-

[1] The views expressed in this document are strictly personal.

residents, thus implying that they are willing to hold assets denominated in that currency. Secondly, it has to be considered an efficient medium of exchange for international transactions, in turn reflected, for instance, in its active use in the invoicing and settlement of global trade of goods and services. Lastly, it should also be widely regarded as a unit of account, be it for commercial or financial flows.

Undoubtedly, these requirements are difficult to meet, if not unsurmountable, for the vast majority of national currencies. Therefore, at present only a handful can be considered as truly international assets. Naturally, the US dollar is the most important among them. According to the most recent IMF data,[2] the US dollar accounts for 63 percent of all allocated foreign exchange reserves globally, more than three times as much its nearest competitor, the euro. Additionally, as the BIS points out in its latest triennial central bank survey,[3] the US dollar is involved in close to 90 percent of all foreign exchange

[2] See "Currency Composition of Official Foreign Exchange Reserves" (COFER), as of the second quarter of 2016.

[3] Bank for International Settlements (2016): "Triennial Central Bank Survey: Foreign Exchange Turnover in April 2016", September. Note that since two currencies are involved in each transaction, the sum of shares in individual currencies adds to 200% in these figures.

transactions, nearly three times as much as the euro, its closest competitor in this regard as well.

New currencies, from both advanced and emerging economies, have been added to the stock of global international reserves in recent years. However, most of them do not fully meet the requirements to be considered a global currency. Furthermore, they remain a tiny portion of the total. If we exclude the US dollar, the euro, the British pound and the yen from the estimates, the share of other currencies in global international reserves amount to around 7 percent at present. When in addition to the above the Swiss franc, the Australian dollar, and the Canadian dollar are omitted, other currencies account for only around 3 percent of the total.

The predominance of the US dollar and a few other currencies in the global system is at first glance incompatible with ongoing changes in the world economy. In particular, the rise of emerging market economies (EMEs) as key, systemic players at a global scale deserves special attention. Currently, these economies are estimated to represent nearly 60 percent of world GDP, and their rates of growth are projected to remain significantly higher than those in the advanced economies (AEs),[4] which points to a continued upward trend in their participation in the global economy. With this in mind, it would seem reasonable to expect emerging market currencies to play a more important role in the composition of international reserve assets.

However, economic size of the issuing country is only one, and not necessarily the most important, determinant of a currency's internationalization. Other elements, such as an economy's role in trade networks; macroeconomic and financial stability; the depth, liquidity and openness of national financial markets; and the stability and convertibility of its currency, are important contributing factors to the latter's role in the global arena.

Certainly, fulfillment of these conditions is challenging, to say the least. Among EME currencies, the Chinese renminbi seems to be the one most likely to achieve a significant role in the global system, partly in view of China's position in the world economy, but also because of the interest the authorities of this country have shown in the internationalization of their currency, for instance through the gradual opening of its financial markets to foreign participation,

[4] International Monetary Fund (2016): "World Economic Outlook", October.

the renminbi´s inclusion in the SDR basket, and the negotiation of currency swap agreements with a significant number of countries.

Nevertheless, a swift move of the renminbi's role to rival some of the main AE currencies looks at this stage uncertain. On the one hand, previous experience with the US dollar during the early 20th century shows that major shifts in the international monetary system can occur rapidly. On the other hand, China is still far away from meeting all the above noted conditions to provide its currency with international status, and the road ahead does not seem to be an easy one. In this respect, Barry Eichengreen has noted that the race to the consolidation of the renminbi as a global currency should be seen as a marathon, and not as a sprint.[5]

But irrespective of the above comments, would an international monetary system with more international currencies be stronger than the present one?

In my view, with a long-term perspective in mind, the answer is affirmative. For one, the more individual economies that enjoy macroeconomic and

[5] Eichengreen, Barry (2015): "China's Money Goes Global: The How, the When and the Why", The Milken Institute Review, Fourth Quarter.

financial stability, are open to trade and financial flows, and have deep and liquid capital markets, among others, the more the system as a whole is likely to be sound and efficient. In addition, a higher number of international currencies entails greater possibilities to diversify overall portfolio risk, a certainly valuable opportunity for asset managers, and especially reserve managers. A multicurrency reserve system, once established, will probably reduce the risk of a persistent overvaluation of assets, including exchange rates. To this, one may add more evenly distributed benefits among countries from their role as reserve issuers, such as seigniorage gains and lower interest rates on their debt, as well as a decreased risk of major and persistent global external imbalances.

On the other hand, it is important to stress that a multicurrency reserve system, as well as the road leading to it, is not free of difficulties. Take the case of renminbi internationalization. This process requires, among other things, a comprehensive opening of China’s financial markets to foreign transactions, as well as a floating exchange rate. As shown by recent episodes, any moves in this direction could have unintended consequences, both for the domestic economy and for the global financial system. More generally, experience demonstrates that the process of financial and exchange rate liberalization in other countries may be accompanied by periods of turbulence. It should also be taken into consideration that, irrespective of the challenges that may be faced in the transition towards international status, the risk of sudden portfolio shifts and the consequent potential for exchange rate volatility will not disappear under a multicurrency reserve system. In fact, it has been noted that a global multicurrency system may lead to greater short-term capital flow volatility and the consequent exchange rate adjustments, as a result of the increased substitutability between currencies. Also, currency internationalization may give rise to other risks, such as a reduced control over monetary aggregates.

Notwithstanding these and other challenges, all in all in the long term the benefits of an international monetary system characterized by a wider availability of international currencies should outweigh the potential costs.