World Reserve Currency Regime

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Canadians, like many nationalities, have a home bias when it comes to investing. The majority, if not all of their investments, such as RRSPs, real estate, mutual funds, segregated funds and businesses, are in Canada and are tied to its future economic growth.

These Canadian investments could see reduced returns in the future, however, due to a growing shift in the balance of economic power towards China and the East and away from the U.S. and Western countries.

Case in point, the Chinese are increasingly flexing their growing economic and political power globally by forming the AIIB (Asian Infrastructure Investment Bank) to finance Asian infrastructure projects. The long term goal is to have the Chinese currency treated as a reserve currency on par with and in competition with the U.S. dollar (USD).

Such a shift will affect investment returns and will impact how your investment portfolios are constructed. The full impact of this shift may take five to ten years to be fully realized but make no mistake, the investment landscape and how you generate investment returns is changing as we speak.

China is expected to be included in the basket of currencies that comprise the International Monetary Fund's (IMF) SDR (Special Drawing Rights) global currency by October of this year. For most of the period following the Bretton-Woods agreement from the late 1940's until the present, the USD has functioned as the primary unit of exchange for settling international trade deals. Inclusion in the SDR would mean international recognition of China's currency as a form of reserve currency and, by extension, its economy.

As recently as 2000, the IMF reported that the U.S. dollar was used to settle international trade deals between countries in over 70% of all global trade activity. Over time, however, as countries have increasingly agreed to settle trade deals between themselves in other currencies such as the Euro and the Chinese Yuan, the U.S. market share has recently fallen modestly to about 60% of global transactions.

The purpose of the reserve currency as a concept in economics is to provide stability and certainty for trading countries to do business together quickly and efficiently. Consequently, processing times required to settle outstanding trade invoices between countries are reduced as well as transactional costs of settling trades.

At present, the IMF's SDR is made up of the USD (47%), the Euro (34%), the pound sterling (12%) and the Japanese Yen (7%). The IMF reviews the SDR basket every five years with the last review in 2010.

Ultimately, the U.S. will have a say in accepting China into the SDR currency regime, which appears to be increasingly likely, as American financial companies are interested in greater access to Chinese capital markets.

As China's central bank governor, Zhou Xiaochuan, stated at an IMF forum in April, the renminbi (the term is used interchangeably with the "yuan") is *"ready for reserve status."* IMF Managing Director Christine Legarde said: *"We welcome and share this objective." "We are now working closely with the Chinese authorities in this regard,"* added IMF Director of Communications Gerry Rice.

Canada only represents about 3% - 4% of the global economy. In the coming years, as the global economic landscape shifts, investment returns will likely come from outside of Canada. Moreover, investors will also need to look beyond the U.S. for diversification.

Call us today to book an appointment to review your current investment portfolios and wealth accumulation strategies to take advantage of the changing economic and investment landscape!

Do you have questions about your investment planning strategies?

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