

Demand for gold predicted to rise in global transition to multi-currency reserve system

Chinese renminbi's role in multi-currency reserve system

Demand for gold is likely to rise as the world heads towards a multi-currency reserve system under the impact of uncertainty about the stability of the dollar and the euro, the main official assets held by central banks and sovereign funds. This is the conclusion of a wide-ranging analysis of the world monetary system by Official Monetary and Financial Institutions Forum, (OMFIF), the global monetary think-tank, in a report commissioned by the World Gold Council, the gold industry's market development body.

Driven by China's desire to increase its financial influence, the Chinese renminbi is likely to emerge gradually as a genuine international currency as Beijing eases restrictions on its use in transactions and investments abroad, but is unlikely to pose any immediate threat to the dollar. Any setbacks to the renminbi's rise as a reserve currency will probably benefit gold as a result of doubts about the overall strength of world monetary arrangements.

The OMFIF report, the product of analysis of historical and contemporary data and discussions with global policy-makers and financial experts, explores the consequences for official asset management of greater dispersion of economic power around the world. It states: 'The world is headed towards the uncharted waters of a durable multi-currency reserve system, where the dollar will share its pivotal role with a range of other currencies, including the renminbi.'

OMFIF believes the re-balancing of the world economy through China's economic rise will occur gradually and will not be straightforward. In particular, the move towards full renminbi convertibility is likely to be only gradual. 'During this period of change and transition reserve holders spread their investments into a relatively wide range of assets and sectors.'

'Gold will neither replace fiat currencies, nor be the dominant "currency" in the system. But it will increasingly have a renewed role in the global monetary system, attracting a higher level of attention from policy-makers and financial market practitioners.'

At a time of world-wide doubt over the resilience of bonds issued by sovereign governments, OMFIF believes that official reserve holders will value gold's attractiveness as an asset that is independent of governments and their large borrowing requirements. Additionally, China's aspiration to take a more assertive role in world politics and economics will encourage Beijing to lead the way in storing its wealth in assets that are not simply the liabilities of other countries

The OMFIF report includes a foreword by Prof. Lord (Meghnad) Desai, chairman of the OMFIF Advisory Board. He states: 'As China weighs up its options for joining in the reserve asset game, gold – the official asset that plays no formal part in the monetary system, yet has never really gone away – is poised, yet again, to play a pivotal role. Many dismiss gold as a relic of the past, but from an asset management point of view as well as on a political analysis, gold has a lot going for it; it is significantly less volatile than most other assets, acts as a hedge against inflation, correlates negatively with the greenback, is effective as a portfolio diversifier and preserver of wealth and no other reserve asset seems safe from impact of the change in the dollar's value.'

The report surveys different economic scenarios for the five years 2013-18. 'Whether the world moves into full crisis with the end of the euro, or whether we have a recovery, or whether we experience something in between: all paths lead to towards a multi-currency system, in which gold's role is likely to become more significant.'

The four scenarios are:

- World economy on smoother path from 2013, euro overcomes crisis
- World recovery muted, euro crisis intensifies, China stimulates domestic demand
- World recovery muted, China endures hard landing
- World recovery slows sharply, euro breaks up

In all these scenarios, the OMFIF report says, the US remains the most resilient of the main world economies. 'Although some imbalances remain – notably on the fiscal side – the US on the whole rebalances more successfully than its competitors.... In all these scenarios, China maintains a continued push for renminbi internationalisation, although the main reasons behind this will change according to the environment.'

The report analyses the reasons behind China's desire to see greater internationalisation of the renminbi. 'Questions over the role and scope of the renminbi go to the heart of world politics and the international trading economy. For fundamental geopolitical reasons, because of national pride and prestige, as well as for profit and convenience, China wants to see its currency play a greater role in the international capitalist system. But it is hemmed in by a variety of constraints, some of its own making, others stemming from the rest of the world's policies.'

The report contains, too, a historical survey of the evolution of reserve currency patterns from the British pound to the US dollar, focusing on gold's monetary use during transition periods from one reserve currency to another.