Excerpt from *Collusion: How Central Bankers Rigged the World* by Nomi Prins

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Strengthening its international capital markets presence, for the first time on September 8, 2009, China issued $878 million worth of sovereign bonds denominated in renminbi in Hong Kong to offshore investors. It was another step to converting the yuan into an international reserve currency. Since 2007, five state-owned Chinese banks had been doing that, including the Bank of China and the China Construction Bank, but only to domestic investors. This was a departure from them.

Battle lines were drawn. International central bankers leveled stronger, coordinated criticism of China's national currency policy. On October 4, 2009, at IMF meetings in Istanbul, the G7 finance ministers and central bankers demanded China strengthen its currency to correct imbalances in global trade. "We welcome China's continued commitment to move to a more flexible exchange rate, which should lead to continued appreciation of the Renminbi in effective terms."

Chinese central bank vice governor Yi Gang responded that China's policy toward exchange rates would continue to emphasize stability. "Our exchange rate policy is very clear," he told Reuters.

Because it foresaw a longer term in which to achieve its goals, the PBOC somewhat relented. In its 2009 Q3 monetary policy report, the central bank signaled it would work on yuan appreciation in the medium/long term and that the yuan's value would be referenced to a basket of currencies and leave aside its dollar peg. This would "enable market supply and demand to play a fundamental role in the yuan exchange-rate formation and to keep the exchange rate basically stable at an adaptive and equilibrium level."

This happened to be in keeping with the Fed and ECB's money-conjuring policy. So, politically, China was choosing to placate the United States, on the one hand, while pushing its agenda forward with the IMF and other countries, on the other.

YEAR OF THE TIGER

While the central banks of developed countries maintained money-conjuring policies in 2010, the PBOC did the opposite. On January 6, it stated that it would "continue to implement appropriately easy monetary policy," but it would also raise three-month bill interest rates. The dual rate decision resulted from the PBOC finding itself caught up in that Triffin dilemma.

Meanwhile, US Treasury secretary Tim Geithner adopted a different, more conciliatory strategy regarding China's yuan policy. During a trip to India in early April 2010, in an interview with NDTV, Geithner said, "I am confident that China will decide it's in their interest to resume the move to a more flexible exchange rate that they began some years ago and suspended in the midst of the crisis."

After India, Geithner traveled to Beijing. There, he had a private conversation with vice premier Wang Qishan. As *China Daily* wrote, "The decision to hold such a high-level encounter suggested that Washington and Beijing are trying to narrow their differences over currency that threaten to overshadow cooperation on the global economy, Iran's nuclear program and other issues." The United States' sudden, more appeasing stance served as a way for the Obama administration to keep China out of Russia and counterbalance Japan's expansion.

Four days later, on April 12, at the biannual Nuclear Security Summit, held in Washington, DC, the currency topic arose. President Hu Jintao told Obama that China would follow its own course in reforming the yuan. It was the first time the two had met since November 2009. Hu affirmed China's autonomy but confirmed, "China will firmly stick to a path of reforming the yuan exchange rate formation mechanism."

The Chinese government and the PBOC loosened the yuan's peg to the dollar on June 19, 2010, as promised. The decision was viewed as a white flag in the spirit of alleviating China-US tensions regarding trade and exchange rate policy. As a result, the yuan hit its highest value in five years against the dollar. The move brought optimism to international markets, and stocks in London, Frankfurt, Paris, and New York rose. Chinese officials began traveling with key bankers to promote the use of the yuan in international trade and capital markets.

That summer, a growing chorus of global private banks promoted the idea that corporations use the yuan instead of the dollar in trade deals with China. The benefit was having more choices in their currency dealings, which meant they could evaluate which currency was more cost-effective or profit-producing rather than be confined to the major existing currencies. HSBC and Standard Charter offered financial incentives to companies opting for such trade deals. Throughout the developed world, these and US banks, such as Citigroup and JPMorgan, accompanied PBOC officials on roadshows to promote the Chinese renminbi.

All of that focus on currency and trade levels served as a diversion from what was really important to China: becoming a superpower. To do so, it was imperative it maintain pressure on the current monetary system. On October 9, 2010, at the twenty-second meeting of the International and Monetary Financial Committee in Washington, DC, Zhou presented a detailed critique of the monetary policies of major countries such as the United States, United Kingdom, European Union, and Japan. According to him, they negatively affected the way emergent countries were supposed to deal with their own monetary policies. He lambasted money-conjuring policies. "Recovery in developed countries continues to rely heavily on unconventional stimulus policies, and private consumption and investment continue to be inhibited by high unemployment and insufficient credit."

He indirectly admonished US and Fed policy regarding handling of the aftermath of the financial crisis and the big US banks that had not been properly punished or restructured: "The countries concerned need to accelerate their disposition of toxic assets, restructure problem institutions, supplement bank capital, strengthen financial regulation, and rebuild sound financial systems." He said, "The continuation of extremely low interest rates and unconventional monetary policies by major reserve currency issuers have created stark challenges for emerging market countries." But the United States wasn't listening to such critiques, certainly not those from China.

Yet, around the world, central banks and finance ministers – implicitly or explicitly, depending on whether they hailed from G7 or G20 nations – became skeptical of the Fed's policies and thus began taking China's side on the matter. Brazil's minister of finance Guido Mantega voiced his concerns on October 8, 2010. On November 8, Germany's finance minister Wolfgang Schäuble waxed so openly critical in an interview with the German newspaper Spiegel that President Obama had to defend the Fed's second round of QE at the G20 summit in South Korea.

On October 19, for the first time since December 2007, the PBOC raised rates by 25 basis points. The yuan had risen 2.5 percent against the dollar since August, its fastest appreciation since the 2005 revaluation. This was the opposite of Fed policy – and was not necessarily intended to appease US currency demands. That November, China hit a record in exports. Its trade surplus relative to the United States exceeded $20 billion for the fifth time in six months. Inflation rose to its highest level in twenty-eight months, at 5.1 percent.

In the United States, all continued as usual. Bernanke was reelected for a second term in the toughest chairman election in Fed history. In November 2010, the Fed began its second round of QE (QE2), purchasing $600 billion worth of US Treasury bonds in $75 billion per month increments. US unemployment had hovered above 9 percent all year, calling into question the effectiveness of US monetary policy to boost growth or job creation.

On Christmas Day, in a one-sentence announcement, the PBOC raised rates another 25 basis points.

YEAR OF THE RABBIT

China continued its attack on the status quo. On January 17, 2011, President Hu Jintao told the US press that an international monetary system dominated by the US dollar is "a product of the past." Nevertheless, he believed it would take time for the yuan to be accepted as a global reserve currency.

Chinese banks, the third pillar of China's power triangle along with government and central banks, were increasing their global presence in lending. Between 2009 and 2010, two major state-controlled Chinese banks, the Export-Import Bank of China and China Development Bank, lent more than the World Bank to developing countries, about $110 billion versus the World Bank's $100 billion.

On February 9, the PBOC raised rates for the third time in four months. The move underscored concern over rising food and commodity prices in emergent countries. It came one week after the IMF's deputy director John Lipsky expressed concern about emergent economies' capacity to sustain growth even as many still had "expansionary" monetary policies. The cure is clear, he said: "Everybody is going to need to tighten monetary policy, reduce budgetary stimulus and continue with the process of structural reforms." None of the world's major central banks adhered to that advice, with the exception of China. The structural reforms part, or austerity, was the way the IMF and World Bank dealt with developing countries, pushing austerity in times of need, constricting citizens instead of speculative opportunists.

On March 5, 2011, opening the annual National People's Congress in Beijing, Chinese premier Wen Jiabao addressed more than three thousand party delegates. He said the government expected an 8 percent growth rate in 2011 and aimed to keep inflation at 4 percent, because he recognized that prices were increasing quickly. "This problem concerns the people's well-being, bears on overall interests and affects social stability." Inflation accelerated despite the rate hikes.

The strategy highlighted differences between China, which juxtaposed monetary policies with concerns over social responsibilities, and Western central banks, which seemed less concerned about people's protests or levying austerity measures. In the middle of 2011, Beijing, increasingly concerned about the social unrest that rising costs could cause, promised to assuage higher prices, such as of pork, a dietary staple, with government intervention. The Western central banks, on the other hand, were cheerleading a supposed recovery in the United States despite prevailing economic anxiety. In Europe, austerity measures were being levied across the so-called PIIGS countries of Portugal, Italy, Ireland, Greece, and Spain, to make up for budget shortfalls. Yet, these shortfalls were the direct results of the financial crisis and the European Central Bank supporting banks and investors through QE over social programs for people. In London, anti-austerity, antibank protestors smashed windows at multinational banks such as HSBC and Santander.

On May 18, 2011, Dominique Strauss-Kahn resigned his position as head of the IMF under the clouds of a sexual assault scandal. In contention for the role of managing director was former French finance minister and international lawyer Christine Lagarde. That was good news for China. In early June 2011, Lagarde visited China and spoke with several key officials there, including foreign minister Yang Jiechi, central bank governor Zhou Xiaochuan, finance minister Xie Xuren, and vice premier Wang Qishan. Prior to her visit, she had traveled to India and Brazil, in keeping with her views on supporting emerging countries.

In Beijing, she told the press that it would be "very legitimate for Chinese representatives to be included at the highest level of the Fund's leadership." It was then that Lagarde and Zhou developed a friendly rapport based on mutual goals. She would have a strong ally in the East if she got the top IMF spot, and he would have an advocate for China in the IMF.

In general, Lagarde was warmly received by the Chinese establishment as a supporter of China's initiatives to take a more prominent role on the global stage. In terms of forging an East-West alliance for the twenty-first century, she was one of the most instrumental world leaders.

On July 5, Lagarde was elected the eleventh managing director (and first female leader) of the IMF. Her only competitor, Mexican central bank chief and prior IMF deputy managing director Agustín Carstens, was supported by Australia, Canada, and Mexico. China supported Lagarde, who supported the inclusion of the yuan in the SDR. So did the United States, which, despite Lagarde's support of China, stuck with the historical protocol of choosing a European leader over the emerging market candidate; also, as central banker, Carstens had focused more on inflation-related rather than money-conjuring policies.

The following month, the yuan crossed the 6.40 line against the dollar for the first time in seventeen years. Meanwhile, Europe was facing a growing debt crisis. The G7 held an emergency Eurozone meeting on August 7, 2011, to consider ways to provide liquidity to the region.

With a possible return to crisis, nothing could be left to chance. The Fed announced it would keep rates at zero. The ECB intervened in Italy's and Spain's bond markets. The Bank of England announced it would provide more stimulus if needed. The BOJ expressed concern about yen appreciation, and Switzerland announced an effort to contain an overvalued franc. They all worried about renewed global recession. In their post-meeting statement, the leaders promised they would "take all necessary measures to support financial stability and growth in a spirit of close cooperation and confidence." Money-conjuring policy had not helped, yet it was the only item on the menu. China continued to stay out of that particular fray.

Still, the credit situation in Europe worsened. On September 25, Lagarde warned that the IMF's $384 billion emergency bailout fund was insufficient to support some countries' current economic situation in worst-case scenarios.

Emerging countries called for solutions to the escalating Eurozone crisis. At the August IMF and World Bank meeting, Brazil's finance minister Guido Mantega had said that Europeans had a responsibility "to ensure that their actions stop contagion beyond the euro periphery." PBOC governor Zhou had echoed this sentiment, stating, "The sovereign debt crisis in the euro area needs to be resolved promptly to stabilize market confidence."

Now China was cast into the position of helper. Europe in need was an opportunity to take a more long-term tack toward a tighter alliance. Zhou told reporters that the timing of China's assistance to Europe depended on what the Europeans did next. He thought the IMF should safeguard the long-term sources of funds to meet the needs of member states to tackle the crisis while promoting international diversification of the reserve currency system. In that way, he was implicitly supporting the weaker European countries over the stronger ones and attacking the prevailing monetary system. Actions were being taken to forge tighter regional relationships, including with Vietnam, Pakistan, and Russia.

On Christmas Day in Beijing, Chinese premier Wen Jiabao met with Japanese prime minister Yoshihiko Noda as part of the Japan–People's Republic of China Summit. In an unexpected decision, the governments announced that both countries would promote direct trading of the yen and yuan, reducing their dependence on the US dollar in these transactions. The agreement was accompanied by one between Japanese and Chinese banks to establish a $154 million fund to co-invest in environmental technology and energy-efficiency businesses.

On New Year's Eve 2011, Zhou told Chinese news agency Caixin that China would maintain a "prudent" monetary path to ensure stability in 2012. He reaffirmed his compromise to "deepen financial reform, accelerate the development of financial markets, and strengthen and improve foreign-exchange management." The performance of the yuan in 2011 was the best since 2009, which highlighted the commitment of the Chinese government to yuan stability and Zhou's plan to turn the yuan into an international reserve currency.

Glossary

ECB: European Central Bank

G7: The Group of 7 consists of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

G20: The Group of 20 consists of Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, United Kingdom, United States, and the European Union.

PBOC: People's Bank of China

Quantitative Easing (QE): The introduction of new money into the money supply by a central bank. Typically, it purchases longer-term securities from the open market in order to increase the money supply and encourage lending and investment.

Triffin dilemma: The difficulty countries have honoring domestic monetary policy concerns while meeting the world's demand for reserve currencies.

SDR: The special drawing rights basket. An international reserve asset created by the IMF within the Bretton Woods fixed exchange rate system. It is composed of weighted currency units from the United States, United Kingdom, European Union, Japan, and now China.

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