US backing for world currency stuns markets

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US Treasury Secretary Tim Geithner shocked global markets by revealing that Washington is "quite open" to Chinese proposals for the gradual development of a global reserve currency run by the International Monetary Fund.

The dollar plunged instantly against the euro, yen, and sterling as the comments flashed across trading screens. David Bloom, currency chief at HSBC, said the apparent policy shift amounts to an earthquake in geo-finance.

"The mere fact that the US Treasury Secretary is even entertaining thoughts that the dollar may cease being the anchor of the global monetary system has caused consternation," he said.

Mr Geithner later qualified his remarks, insisting that the dollar would remain the "world's dominant reserve currency … for a long period of time" but the seeds of doubt have been sown.

The markets appear baffled by the confused statements emanating from Washington. President Barack Obama told a new conference hours earlier that there was no threat to the reserve status of the dollar.

"I don't believe that there is a need for a global currency. The reason the dollar is strong right now is because investors consider the United States the strongest economy in the world with the most stable political system in the world," he said.

The Chinese proposal, outlined this week by central bank governor Zhou Xiaochuan, calls for a "super-sovereign reserve currency" under IMF management, turning the Fund into a sort of world central bank.

The idea is that the IMF should activate its dormant powers to issue Special Drawing Rights. These SDRs would expand their role over time, becoming a "widely-accepted means of payments".

Mr Bloom said that any switch towards use of SDRs has direct implications for the currency markets. At the moment, 65pc of the world's $6.8 trillion stash of foreign reserves is held in dollars. But the dollar makes up just 42pc of the basket weighting of SDRs. So any SDR purchase under current rules must favour the euro, yen and sterling.

Beijing has the backing of Russia and a clutch of emerging powers in Asia and Latin America. Economists have toyed with such schemes before but the issue has vaulted to the top of the political agenda as creditor states around the world takes fright at the extreme measures now being adopted by the Federal Reserve, especially the decision to buy US government debt directly with printed money.

Mr Bloom said the US is discovering that the sensitivities of creditors cannot be ignored. “China holds almost 30pc of the world’s entire reserves. What they say matters,” he said.

Mr Geithner’s friendly comments about the SDR plan seem intended to soothe Chinese feelings after a spat in January over alleged currency manipulation by Beijing, but he will now have to explain his own categorical assurance to Congress on Tuesday that he would not countenance any moves towards a world currency.

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