Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

By: Daniel Lacalle

Are the BRICS a threat to the U.S.?

The summit of the so-called BRICS (Brazil, Russia, India, China, and South Africa) has closed with an invitation to join the group extended to the Emirates, Egypt, Iran, Saudi Arabia, Argentina, and Ethiopia.

The summit has generated a lot of headlines about the impact of this widespread group of nations, including speculation about the end of the U.S. dollar as a global reserve currency if this group is perceived as a threat to the United States or even the International Monetary Fund.

Several things need to be clarified.

Many political analysts believe that China lends, invests, or supports in return for nothing. China is a major economic power, but it has shown no interest in making the yuan a global reserve currency.

Its currency is closely managed and currently used in 5% of global transactions, according to the Bank of International Settlements.

China and Russia have capital controls. It is impossible to have a global reserve currency without freedom of capital movement. More requirements are needed than solid gold reserves to have a stable fiat currency.

It is essential to guarantee economic freedom, investment, legal security, and the free movement of capital, as well as an open, transparent, and diversified financial system.

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China and Russia are also much more demanding and rigorous lenders than many politicians think. Looking at the headlines, it seems that some emerging market politicians think that joining China and Russia will be a kind of free money panacea.

Another problem with creating a BRICS currency is that, logically, neither China nor Russia has the slightest intention of losing their national currency to dilute it alongside a group of issuers who have a doubtful track record in controlling their monetary imbalances.

Over the past ten years, the currencies of the BRICS guest countries have depreciated significantly against the U.S. dollar. The Argentine peso has fallen by 98%, the Egyptian pound by 78%, the Indian rupee by 35%, the Ethiopian birr by 68%, the Brazilian real by 55%, according to Bloomberg, and the Iranian rial has collapsed by 90%, according to The Economist.

Putting together weak currencies does not create a strong currency. However, increasing the global use of the yuan or the ruble is much more likely.

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We must not forget that the performance of the Russian ruble (-68% against the U.S. dollar, according to Bloomberg) in the last decade has also been poor despite having a relatively prudent central bank.

The best "BRICS and guests" currency against the U.S. dollar in the last ten years is the Chinese yuan, with a depreciation of only 14%.

For a fiat currency to be stable, it is necessary that the issuer defends it as a reserve of value, a generally accepted payment method, and a unit of measure. Freedom of capital and independent institutions that provide legal security to domestic and international investors are essential.

Moreover, China seems to have no interest in taking on all the challenges required to be a global reserve currency, starting with a financial and monetary system with a high level of independence from political power. It can extend the use of the yuan through its

financial system and lending to partner nations.

Many analysts ignore that what has made the Federal Reserve a success as the world's central bank is that it is not under total state control or public management.

The Fed may not be completely independent, but it is as independent as a central bank for a fiat currency can be.

Joining countries with governments that advocate monetizing uncontrolled public spending and massively increasing monetary imbalances cannot create a stable currency unless they implement the example of the euro, which seems unlikely.

In the euro, Germany, the country with the most prudent and responsible fiscal policy, dictated the main lines of the monetary and fiscal rules to the rest.

Unfortunately, the eurozone and the ECB, in trying to play to be the U.S. and the Federal Reserve, have lost most of their options to be a real alternative to the U.S. dollar... And the euro is the greatest fiat monetary success in the post-Bretton Woods era; let us not deprive it of its merit.

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The BRICS alternative currency would start with significant problems. China and Russia would have major difficulties imposing fiscal and monetary policy restrictions on their partners.

Let us not forget that several of these partners have joined the group thinking that from now on they will be able to continue printing money and spending without control, while their monetary imbalances will be distributed to other nations.

The euro has been a fiat world success because democracies with independent institutions and broad economic freedom and legal certainty agreed to align their policies for a common project, creating a solid currency that avoided the debacle created by the inflationary spirals that were the norm in Europe historically when governments devoted themselves to transferring their imbalances to citizens' wages and savings through monetary destruction. This does not seem easily replicable with BRICS and guests.

China, however, can increase its global leadership by implementing rigorous monetary and fiscal policies. It is the strongest lender of all the BRICS, but it is unlikely to take on the role of the euro's Germany, a nation willing to absorb the excesses of others in exchange for a common project.

China is probably going to increase its control over the countries in the group, but it is not likely to jeopardize the stability and security of its enormous population by betting on a new currency.

The Chinese government is probably analyzing how the euro may be losing its monetary strength by implementing negative rates and monetization of public deficits and reaching the conclusion that it cannot take that same risk with some of these new partners.

However, China will probably make the most of its financial strength to lend, increase their domestic and international growth options, and access abundant and cheap commodities.

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China is the big winner of the BRICS summit. The Chinese government probably knows that many of its partners are going to continue increasing their imbalances, and this may allow China to strengthen its leadership position.

However, I find it hard to believe that China

will agree to the creation of a currency that others can use to trigger inflationary imbalances.

Meanwhile, in the U.S., the government may jeopardize the credibility of the U.S. dollar if it continues to generate deficits of two trillion dollars a year, more than a $14 billion estimated deficit by 2030, and with an increasing number of irresponsible advisers saying that it can create all the money it wants without risk.

The fiscal credibility, institutional independence, and economic freedom of the U.S. dollar, the most widely used currency in the world, cement its currency leadership. If the government undermines these strengths, the dollar will lose its reserve status.

The end of the U.S. dollar, if it comes, will not likely arrive through competition from another fiat currency, as the temptation of governments to destroy the purchasing power of the issued currency is too strong. It will probably come from independent currencies.