Businesses and governments around the world are watching as China grows, innovates and extends its influence. We explore how the country got to where it is and what might be in store for its future in our series Understanding China’s Influence .

In Chinese, “renminbi” means the currency of the people. Yet for so long China’s currency has been an institution of state-run capitalism, serving vested interests under an investment driven growth model. The reforms that accompanied the yuan’s globalisation have helped transition China to a more sustainable economy by empowering consumers and private investors.

The yuan (or renminbi, RMB) was recently included in the basket of currencies called the Special Drawing Rights (SDRs), used to value the International Monetary Fund’s (IMF) de facto monetary unit. This means the yuan has been accepted as an IMF endorsed international reserve currency, which is often widely used by central banks to hold foreign exchange reserves. Media estimates suggest the SDR inclusion should lead to about US$42 billion of reserve assets being rebalanced into the yuan by central banks and reserve managers, at least in the medium term.

The yuan’s joining of the SDR reserve currency club, with the dollar, pound sterling, yen and the euro, is comparable to China’s accession to the World Trade Organisation (WTO) in 2001. Both heralded further opening up of the Chinese economy.

However, a notable difference with the SDR is that, compared with just commitments to enter the WTO, joining the SDR requires concrete reforms to meet the IMF’s standards. Apart from years of lobbying the IMF, the Chinese government has used a whatever-it-takes approach, supported from the very top of the political echelon, in its quest for the yuan’s international appraisal.

The yuan has become stronger in the global scene as China becomes the largest trader and the second largest economy in the world.

The government is promoting trade settled in yuan, it relaxed its control on capital and opened domestic financial markets. Yuan-denominated assets have multiplied and diversified and the setting of the yuan's exchange rate is now more market-oriented.

Relegation of the yuan lower down the priority list

During my recent interviews, one official from the People's Bank of China (the central bank) candidly said, "the last thing we want to talk about is the renminbi at the moment". I heard the same a decade ago when the Chinese government was facing mounting pressure from the US over alleged undervaluing of the yuan. This time, however, it's more of a domestic concern.

A largely speculative property market is sucking in capital from the real economy whose growth has been lacklustre in recent years, and forced an increase in the household debt level.

The 2016 IMF review of the Chinese economy also waved a red flag over China's ballooning debt, which rose to a record 237% of gross domestic product (GDP) in the first quarter of 2016. The biggest chunk of the debt pile, 145% of GDP, goes to its corporate debt, a level that was "very high by any measure".

Worries of a potential debt crisis and a lack of alternative investment channels have seen renewed flow of capital out of the country. A widely anticipated shakeup of the financial regulatory regime has been in disarray since the stock market crash last year.

So it's not surprising to see that, although the government ensures stability of the yuan's value, it has devalued by more than 1% after the SDR inclusion, approaching a new low in almost six years.

The future of the yuan

It's worth noting that being part of the SDR basket is not a permanent status. The IMF reviews its elite currency group every five years, and those that fail to meet the standards may be removed.

In addition, an SDR membership is a milestone, but far from the final point in the yuan's march of internationalisation. It's convincing the market to accept the yuan that really matters. To achieve this, China needs to further liberalise and open up its economy and financial markets.

But perhaps the Chinese government's logic in macroeconomic management is what is problematic. Instead of seeing yuan-related financial reform as hindering stability and growth, further reforms can not only consolidate and promote the yuan's global status, but also hold the key in solving the big-picture issues at home.

Enhancing the power of the central bank, a liberal force in China's financial governance and staunch promoter of the yuan, will enhance China's macroeconomic capacity and overall financial and economic stability. Allowing freer capital flow will help deflate the overheated housing market and liberalising interest rates will increase the efficiency of financial resources and foster market-oriented debt.

Any efforts by China's central bank to further align the yuan's exchange rate to market expectations, ultimately leading to its free float, are likely to prepare domestic businesses for international competition. Businesses need the government's shield, to establish international confidence in the currency and the Chinese economy.

The reforms have to go on. The yuan must serve the people before conquering the world.

Hui Feng receives funding from the Australian Research Council.

Read more http://theconversation.com/chinas-currency-needs-reform-at-home-before-gaining-more-traction-internationally-66915