BRICS: The new name in reserve currencies

Raising some eyebrows today has been an address by President Putin outlining that Brazil, Russia, India, China, and South Africa (BRICS) are developing a new basket-based reserve currency. The presumption is that it will comprise real, roubles, rupees, renminbi, and rand and present an alternative to the IMF's Special Drawing Right (SDR).

Russian President Vladimir Putin

Spheres of influence

News that Russia seems to be leading a discussion on a new reserve currency perhaps should not come as such of a surprise. The speed with which western nations and its allies sanctioned Russian FX reserves (freezing around half) no doubt shocked Russian authorities. The Central Bank of Russia effectively admitted as much and no doubt some BRICS nations – especially China – took notice of the speed and stealth at which the US Treasury moved.

BRICS nations may therefore feel they need an alternative reserve currency to match something like the IMF's SDR. Recall that the IMF's SDR is not a currency, but effectively a basket of claims on top reserve currencies such as the dollar, the euro, the pound, the yen and its most recent addition the renminbi.

There are about US$950bn worth of SDR outstanding and these are designed to supplement IMF member's reserves. Most notably in August 2021 there was an additional SDR456bn released to IMF members to ease balance of payments financing needs following the shock of the pandemic.

Why would the BRICS countries need an SDR-like basket currency? One can only think this is a move to address the perceived US-hegemony of the IMF and will allow BRICS to build their own sphere of influence and unit of currency within that sphere. Intriguingly this week has seen news reports that Russia might want to address rouble strength by managing it against peg or basket. Could the BRICS be the basket against which the rouble is managed? We know that the CBR is not a fan of managing the rouble, however.

Without discussing the likelihood of such a proposal turning into something tangible, Russia may have a strong motivation to participate or initiate in an IMF-like scheme in order to address the mounting pressure on its capital account. Russia is used to being a net creditor to the rest of the world, as its big trade surplus would normally be balanced by the capital outflow (purchase of foreign assets). Now, in the new geopolitical reality, Russian investments are no longer welcome at its usual DM destinations due to sanctions/legal restrictions and in some cases - individual decisions by financial institutions. At the same time, the context of growing global rates may create demand in EM and frontier space for external financing at a competitive cost

Market implications

This may just be a trial balloon floated by President Putin, but what are some of the early considerations? Will the BRICS basket attract many FX reserves from the BRICS countries themselves or from nations seen as within their sphere of influence – e.g., countries in the CIS, or more friendly regimes in the Gulf or South Asia?

We should not forget the mantra of what makes a good reserve currency: 'safety, liquidity and return'. On the safety front, sovereign credit quality will clearly be an issue for any BRICS-basket currency, where a simple weighted average of 5-year sovereign credit default swaps (CDS) trades at least twenty times wider than a similar CDS average for SDR currencies. When it comes to FX liquidity suffice to say a basket of BRICS currencies operates in a different universe to those currencies in the SDR. The average deposit/yield on a BRICS basket would be far higher, but that is because of the much poorer credit quality where, incidentally, it looks like Russia will shortly go into sovereign default.

Our early thoughts are that this news would not be enough to trigger any substantial out-performance – relative to current fundamentals – of the BRICS currencies. While there could be some high-profile statement of political ambitions to embark on this project, we doubt the mercantilist nations involved in BRICS would want to transfer valuable FX reserves into this more local sphere of influence. If they are worried about the path of sanctions and the increasing weaponization of the dollar, they, like Russia, might prefer to move into Gold.

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