



恒生銀行

HANG SENG BANK

# Press Release

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## CHINA'S FOREIGN EXCHANGE RESERVES HELP SUPPORT FINANCIAL REFORM

The rapid rise in China's foreign exchange reserves will provide the country with greater resources to proceed with financial reform, and to strengthen its financial system, which will ultimately pave the way for full capital account convertibility, states the latest issue of *Hang Seng Economic Monthly*.

Over the past 24 months, China's foreign exchange reserves have been growing rapidly by an average of around USD16 billion per month to reach USD769 billion at the end of September this year. Judging from recent trends in China's capital inflows and current account, the country's foreign exchange reserves are predicted to become the largest in the world by the end of 2006.

Observers have questioned the desirability of both the level of China's foreign exchange reserves and the pace at which they are accumulating. However, the report states that such concerns are largely unjustified.

Although the absolute level of China's reserves is high, relative levels as measured against such parameters as GDP, imports or money supply are quite modest. The report also notes the role of foreign exchange reserves as a buffer against both external and internal economic shocks should they arise.

Concerns over the speed at which reserves are accumulating have more weight, states the report. As foreign exchange reserves grow, the People's Bank of China ("PBOC") sells equivalent amounts of RMB, boosting the money supply. Some fear that if the rapid rise in reserves continues, this will lead to a relaxed monetary environment, increasing the risk of economic overheating and making economic control more difficult.

However, the report points out that this has not been a problem over recent years. The PBOC has successfully managed the monetary environment through a policy of 'sterilisation', or the sale of central bank bills to absorb the growth in money supply. Along with credit control measures, this policy saw money supply growth slow from 23% to 15%-17% over the past year. The report also notes that China's high economic growth rate requires significant growth in annual money supply to support it.

At its current stage of economic development, large foreign exchange reserves offer China several benefits, states the report.

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Sustained economic growth will require increasing inputs of energy and commodities. China has a plan to set up strategic reserves of several key commodities and this will require significant foreign exchange payments.

As China continues with financial sector reform, big foreign exchange reserves will play an important role in offering some degree of insurance against any crisis in the domestic banking sector. They should also help underpin confidence and stabilise the economy as China moves forward with liberalisations of the country's capital controls, the report adds.

The report states that China's soaring reserves can be attributed to persistent current account surpluses, growing capital inflows, and market expectations with respect to the revaluation of the RMB.

China's continuing market liberalisation under its WTO accession agreement has led to a marked rise in foreign capital inflows since 2001. Exports have doubled over the past three years which has helped push up the country's current account surplus. Further, the holding of RMB assets by overseas investors has become more popular.

The upward trend in China's foreign exchange reserves reflects the country's fundamental economic strength and is likely to continue for at least as long as it takes for capital account controls to be further liberalised.

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