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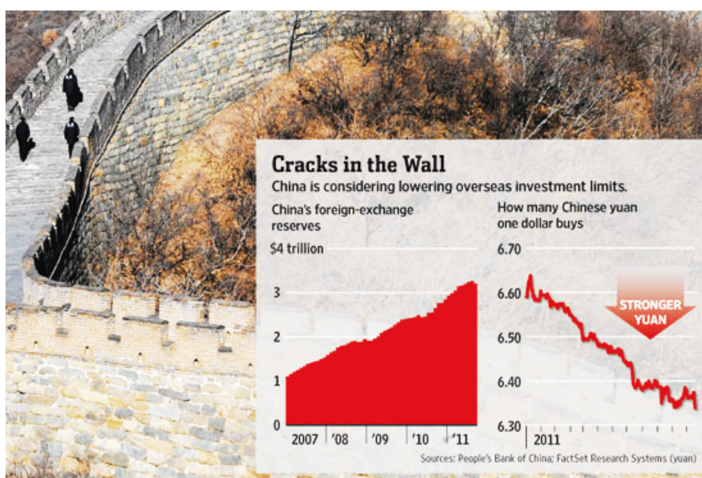
Beijing Considers Easing Cash Rules

By LINGLING WEI DECEMBER 20, 2011

BEIJING—China is weighing measures to enable its citizens to invest more overseas as part of its efforts to diversify the country's $3.2 trillion foreign-exchange reserves, according to people familiar with the matter.

But big hurdles could hold up such a move, including fears of excessive capital outflows as China's economy slows, the people cautioned.

The State Administration of Foreign Exchange, the country's currency watchdog and part of China's central bank, is considering gradually expanding how much foreign currency Chinese individuals can purchase every year for the purpose of investing overseas, the people said. Currently, Chinese nationals can exchange as much as the equivalent of $50,000 a year into foreign currency. SAFE didn't respond to requests for comments.



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Raising the quota would represent a small but significant step toward opening China's capital account, which is tightly controlled by the authorities as a way to manage the exchange rate and prevent speculative capital flows. Chinese regulators generally have to approve any sizable amount of currency—foreign and domestic—flowing in and out of the country.

The deliberation comes as the Chinese currency has faced downward pressure against the U.S. dollar. Investors and businesses have lowered their expectations for a continued rise in the yuan's value, betting that slumping demand for exports will prompt Beijing to slow or even halt currency appreciation to help stave off unemployment.

The recent ups and downs in the yuan's trading, many say, represent a sign of maturing for the developing market that could lead to a greater willingness among Chinese households to diversify their earnings into foreign currencies; citizens may be more inclined to hold dollar assets when the yuan falls.

The two-way fluctuations "should serve as a very good condition for us to reasonably open the capital account," Li Daokui, an adviser to the People's Bank of China, the central bank, said at a forum Friday. "We can encourage households to hold U.S. dollars and to buy foreign assets, such as U.S. securities, through commercial banks."

Mr. Li also emphasized the need to have "a valve" in place to block big capital outflows, should China move toward loosening its capital controls.

China's reformers hope a policy change could help improve returns on China's foreign-exchange reserves, the world's largest at $3.2 trillion. They have largely been invested in low-yielding instruments such as U.S. Treasury bonds. Concerns about the dollar's longer-term prospects have contributed a sense of urgency in recent months to China's ambitions to give the yuan a more global role while reducing the country's vast dollar holdings. The risk of dollar exposure was underscored during the summer, when Standard & Poor's cut its rating on U.S. government debt, unnerving global markets.

Zhou Xiaochuan, the PBOC governor, said in October that the government may allocate more resources and assets to Chinese households in the future, using the Chinese term "*cang hui yu min*," meaning storing foreign-exchange reserves among the people.

Allowing the private sector to play a bigger role in managing the reserves could facilitate capital moving in and out of China's borders in an orderly way, analysts say, thereby helping reduce the country's persistent balance-of-payments surplus, which has resulted from its trade surplus and an investment boom. That, in turn, could help alleviate the pressure on continued yuan appreciation. A potential new policy could help encourage consumption, said Li Wei, an economist with Standard Chartered in Shanghai. "The challenge is how to manage the risks, as China's financial markets are still not deep and liquid enough to withstand any kind of sudden capital flows," Mr. Li said.

Indeed, concerns about huge amounts of capital leaving China have accelerated following a PBOC report last month showing a sharp decline in foreign-exchange purchases by banks in October. Analysts at Citigroup and Standard Chartered have said the drop had more to do with Chinese companies selling less foreign currency on reduced expectations for yuan appreciation than with capital flowing out of the country.

Still, at a time when China's economic growth is slowing in the face of a likely recession in Europe and a weak recovery in the U.S.—China's two largest trading partners—policy makers are wary of the potential for any big capital outflows, the people with knowledge of the matter said. Also of concern is the potential to make it easier for corrupt officials to take money out of the country, the people said. "There are still uncertainties over whether and when the new policy will be implemented," a person familiar with the matter said.

At present, Chinese individuals have very limited channels to invest overseas. They often have to set up companies for that purpose or invest through the so-called Qualified Domestic Institutional Investor program, or QDII, which provides a controlled avenue granted by China's regulators for domestic investors to park their funds in foreign securities.

Since its launch in 2006, the QDII program hasn't proven popular with Chinese investors, largely because many QDII products are linked to fixed-income securities, and Chinese investors have received higher returns from buying domestic equities.

Now, Chinese demand for foreign assets is likely to increase, bankers and analysts say, as mainland China's markets grapple with a slowing economy and as more high-net-worth Chinese individuals seek to invest outside of the country.

"The government is never going to take big risks when managing the reserves, so it makes sense for the private sector to get a piece of the pie to help boost returns," said Peng Junming, a former SAFE official who now runs his own investment-management firm, Empire Capital Management LLP.