

Money

Hot money inflows put govt in a quandary

By Xin Zhiming (China Daily)
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Yuan appreciation hopes, rampant dollar carry trade possible causes

Beijing - The government is facing pressure to curb abnormal capital inflows into the country, the State Administration of Foreign Exchange (SAFE) said on Thursday, even as analysts warned that such pressures would remain given the expected gradual appreciation of the currency.

The rampant dollar carry trade, the interest rate difference between the yuan and the dollar, and expectations of yuan appreciation are causes of such capital inflows, the foreign exchange regulator said in a statement.

"The task of promoting the balance of international payments remains challenging," it said.

The interest rate difference between the two currencies is about 2 percentage points, which encourages cross-border carry trade. China's decision to make the yuan more flexible against a basket of currencies on June 19 has fanned expectations that the yuan would appreciate gradually against the dollar.

While analysts said the yuan's value would not change dramatically against the dollar in the short term, it would continue to rise gradually.

"China cannot afford a one-off revaluation of the yuan," said Li Jianjun, an economist with the Central University of Finance and Economics. "The expected gradual appreciation, however, would lead to continued inflows of speculative capital."

According to Li there should have been huge inflows of speculative capital in the first half of the year, taking into consideration the trade and capital account figures. "They may have come into China in the name of trade transactions," he said.

In the long run, thanks to the loose monetary policy of the US, the dollar would turn weak, despite its recent strong rises against a turbulent euro, Li said. That in turn, means that the relatively strong yuan would see more capital inflows.

The regulator, however, said capital flows could be a two-way movement. "If the dollar's interest rate and exchange rate rise continually, it could lead to capital outflows and it cannot be excluded that some accidents hurt market confidence (in Europe) and cause abnormal cross-border capital flows."

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The pressure of net foreign exchange inflows eased in May compared with in April, the peak period for such inflows, the regulator said, because of declining expectations that the yuan would gain.

The yuan has risen more than 0.7 percent against the dollar since the central bank decided to end a two-year yuan peg to the dollar on June 19. However, the US has said the pace is far too slow, despite widespread concerns within China that fast yuan appreciation would be detrimental to trade and overall economic growth.

The International Monetary Fund said on Thursday that



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China's gross domestic product is expected to grow by 10.5 percent year-on-year this year, compared with 11.9 percent for the first quarter.

Top policymakers have expressed concern about an economic slowdown in the second half of this year. The real estate tightening policies, controls on bank lending and external uncertainties, such as the European debt crisis, have dampened growth prospects.

Many economists expect the government to fine-tune its policies after the release of the second-quarter economic indicators on July 15 to prevent a serious slowdown.

The central bank said on Thursday that it will maintain its moderately loose monetary policy. " (We) will closely monitor the development of the economic and financial situation and ensure proper growth of lending," it said in a statement after a quarterly monetary policy meeting.

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