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Record leap in China forex reserves reflects global imbalance

By Geoff Dyer and Jamil Anderlini in Beijing

China's foreign exchange reserves jumped by a record $199bn in the last quarter of 2010, taking the total to $2,850bn and underlining the continuing imbalances in the global economy.

Already the largest in the world, China's reserves rose by 18.7 per cent during 2010, including an increase of $194bn in the third quarter.

Although the monthly trade surplus dropped in December, the continued strong increases in foreign exchange reserves will bolster the case of critics calling for a more rapid appreciation of the renminbi.

The central bank intervenes in the market by buying foreign exchange with renminbi in order to hold down the value of its currency, and the foreign exchange that it buys ends up in its reserves.

Currency and trade issues are likely to feature strongly when Hu Jintao, the president, makes a state visit to the US next week.

The continued rise in reserves is complicating the management of monetary policy at a time when strong bank lending and a rising money supply are adding to inflationary pressures. "China's continued strong bank lending and massive reserve accumulation could be bellwethers of trouble to come," said Eswar Prasad, former head of the International Monetary Fund's China division.

"They throw cold water on the notion that macroeconomic policies have the economy under control and have struck the right balance in keeping growth high while preventing overheating."

The central bank said the total stock of new loans in 2010 was Rmb1,650bn less than the amount issued in 2009, but some analysts believe the official figures understate the true scale of bank lending.

"Talk of a substantial slowdown in credit growth in China is premature, but understandable given the visible drop in official figures on net new loans," said Charlene Chu, head of financial institution ratings at Fitch in China, in December. "However, in reality, lending has not moderated, it has been diverted into other channels."

Fitch argues Chinese banks simply offloaded trillions of renminbi in loans from their balance sheets in 2010 by artificially reducing their holdings of discounted bills and by repackaging loans into investment products for sale to investors.

The headline figure for China's reserves reflects the trade surplus, direct foreign investment and inflows of short-term capital, although it is also affected by the impact of exchange rate movements on the value of Chinese assets.

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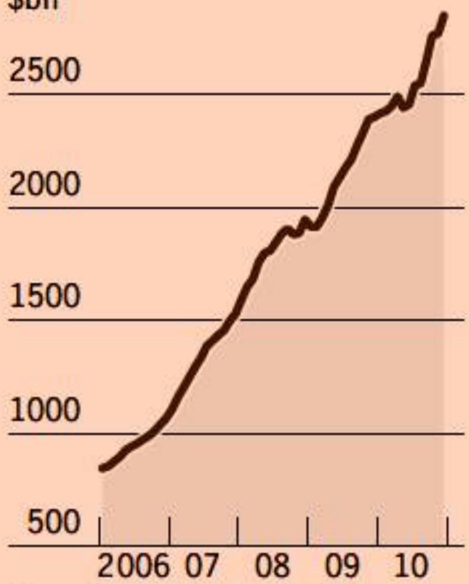
Surging ahead

Chinese foreign exchange reserves

$bn



Source: Thomson Reuters Datastream