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China bank governor talks bluntly as retirement looms

Zhou's candour over 'Minsky moment' warning highlights concern for his legacy

Zhou Xiaochuan: 'No country can achieve an open economy with strict foreign exchange controls' © Bloomberg

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When Zhou Xiaochuan last week used the phrase "Minsky moment" to warn against complacency during the current period of unexpectedly strong Chinese growth, it was not the first time the central bank chief had highlighted risks from excessive debt and speculative investment.

But Mr Zhou, governor of the People's Bank of China, would surely have known that the colourful phrase — redolent of the 2008 financial crisis, which resurrected the reputation of the US economist Hyman Minsky — would grab headlines.

Mr Zhou's statements about Chinese economics and policy have become increasingly candid in recent weeks, and central bank watchers say it is no accident. At the same meeting where he warned of Minsky-ite risks, Mr Zhou, 69, confirmed that he would retire "soon" after serving since 2002, the longest tenure of any PBoC chief.

As rumours swirl about his possible successor, observers say Mr Zhou's increasing bluntness reflects a final appeal directed towards Communist party elites to continue financial reforms that he has advocated but that have suffered setbacks over the past year.

“It looks like Zhou is making a last ditch argument into the system for his long-held belief in financial liberalisation. He’s saying, ‘We started on this path, please don’t abandon it’,” says Andrew Polk, co-founder of Trivium China, a Beijing-based research group.

A week before his Minsky comment, Mr Zhou urged further easing of capital controls in an interview with local media. At a forum in March, Mr Zhou warned that failure to permit foreign banks greater access to the Chinese market could lead to “laziness and weakness” among domestic rivals.

Mr Zhou was the mastermind behind China’s campaign to win the International Monetary Fund’s endorsement of the renminbi as a reserve currency by including the redback in the basket that comprises the fund’s Special Drawing Rights.

Analysts praised Mr Zhou’s political savvy in using the international prestige of SDR membership to build support for financial reforms that faced resistance from conservative elements in the party. But that campaign has stalled as authorities moved to staunch capital flight and prevent a depreciation of the renminbi.

“Governor Zhou has been instrumental in pushing forward capital-account opening, financial market reforms, and improvements to monetary and exchange-rate policies. (But) progress in these areas has been limited and slow and has fallen short of the objectives he has often articulated,” says Professor Eswar Prasad of Cornell University, and former China head for the IMF.

For regulators, the dilemma is that on the one hand, permitting capital outflows can create useful pressure on domestic financial institutions to deal with bad debt and improve their balance sheets, by forcing them to compete with foreign counterparts for investor funds.

On the other hand, allowing unrestricted outbound investment while domestic financial risks remain unresolved risks unleashing a torrent of outflows that destabilises the economy, as China’s neighbours learned during the Asian Financial Crisis. Indeed, in other remarks this year, Mr Zhou defended the clampdown on outflows.

“One of his greatest achievements is renminbi internationalisation, but without capital-account opening, you cannot say that the renminbi is a global currency,” says Jianguang Shen, chief economist at Mizuho Securities Asia. “Even though there are temporary setbacks, he wants to make sure that the overall direction is toward more openness.”

The two leading candidates to replace Mr Zhou are Jiang Chaoliang, a veteran banker and the party boss of Hubei province, and Guo Shuqing, who now heads China's banking regulator.

"Jiang is still seen as the likelier of the two, but it's a toss-up," says one person close to senior Chinese financial officials. As party secretary of a large province, Mr Jiang is technically a "bigger beast" in Chinese politics than Mr Guo, who was the second-highest ranking official in Shandong province before being transferred to the China Banking Regulatory Commission in February.

But Mr Guo is an accomplished technocrat and protégé of former premier Zhu Rongji, who has led the party's charge against financial risk this year. His appointment as central bank chief would be widely welcomed by Chinese officials and foreign diplomats who hope Mr Xi will reinvigorate financial reform.

Beyond domestic policy debates, analysts say Mr Zhou's recent candour is also probably intended to burnish his international legacy as he prepares for the next phase of his life. His English language ability, wry humour and relaxed demeanour have made him popular among foreign officials.

"He's trying to remind everyone that he has been a reformer over 15 years at the helm of what has arguably become the second-most important central bank in the world," says Mr Polk. "It's both for his own reputation and because he actually believes it."

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This article has been amended to reflect the fact that Jianguang Shen was a visiting scholar but not a staffer at the People's Bank of China.