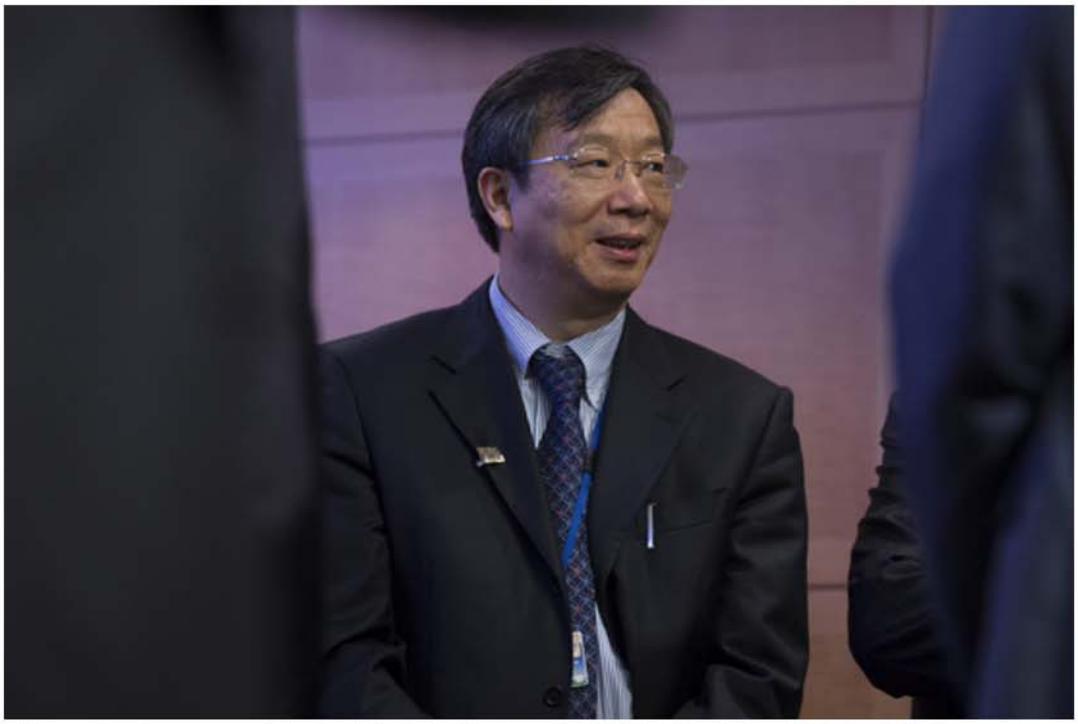
THE WALL STREET JOURNAL.
WSJ.com

June 9, 2014, 8:32 AM HKT

PBOC Vice Governor's Star Rises



Yi Gang, deputy governor of the People's Bank of China, at the G-20 in Washington in October 2013.

Bloomberg News

Yi Gang, a vice governor at China's central bank who is in charge of managing the country's nearly $4 trillion in foreign-exchange reserves, has quietly been named a senior official in the Communist Party's top economic advisory group–a body akin to the White House's National Economic Council, according to officials with knowledge of the matter.

The appointment suggests China's leadership continues to put a priority on financial reforms, the officials say, and reflects the growing clout of Mr. Yi and his mentor, central bank Gov. Zhou Xiaochuan. It may even give Mr. Yi, an American-trained economist, the party-insider cred to make him a possible successor to the 66-year-old Mr. Zhou, who already is serving beyond the usual retirement age of 65.

For years, Messrs. Yi and Zhou have been pushing to make it easier for money to flow in and out of the country and to give the market a greater role in setting both exchange rates and interest rates. So far this year, China has allowed the tightly controlled yuan to trade a bit more freely, issued plans to permit some local governments to sell bonds on their own credit and taken some more steps toward freeing up the deposit rate.

In April, Mr. Yi said at a panel hosted by Johns Hopkins University in Washington that the People's Bank of

China is pressing ahead on exchange-rate reforms in a “bold” fashion while adopting a more gradual approach toward loosening controls over interest rates and capital markets. Mr. Zhou has said he wants to let the market set China’s bank deposit interest rates within two years. Last year, the PBOC made a similar move when it came to bank lending rates.

“You can push all three simultaneously,” Mr. Yi said, referring to reform of interest rates, exchange rates and capital inflows. “In my mind, there’s a sequence. You have to, in a bold fashion, liberalize the exchange rate … You can do some cautious, step-by-step interest rate liberalization.”

The movement on the financial end contrasts sharply with the plodding pace of reform elsewhere. For instance, little has been done to remake the fiscal system and the vast state-owned corporate sector.

Mr. Yi earned a Ph.D in economics from the University of Illinois and taught for six years at the University of Indiana, whose alumni events he still participates in. The 56-year-old economist is a favorite of Western financial officials, who say that his appointment to the economic advisory group–called the Office of the Central Leading Group for Financial and Economic Affairs–could give him the additional clout to succeed Mr. Zhou, especially if the PBOC governor were to leave before his latest five-year term ends in 2018.

Mr. Yi would still be a long shot, China economists say, because he doesn’t now have senior standing in the Party. China banking regulator Shang Fulin and Shandong province Governor Guo Shuqing are considered by Chinese academics and American China watchers more likely PBOC heads. Both are members of the party’s 205-member, decision-making Central Committee. Mr. Yi isn’t even an alternate, or nonvoting, member.

People who have worked with Mr. Yi describe him as scholarly and hard-working. “He is quite professorial in his approach to things–methodical, analytical and open to different points of view,” says Eswar Prasad, a Cornell University economist and former senior official at the International Monetary Fund who has known Mr. Yi for years. He is “an academic at heart,” says Mr. Prasad.

Mr. Yi has argued that China’s immense build-up of reserves has become counterproductive, in part, because it is losing money in the transactions. Beijing uses the dollars that flow into China largely to buy U.S. Treasuries, which carry low interest rates. It then pays domestic banks a higher rate of interest to mop up excess liquidity in the market. Premier Li Keqiang, echoed Mr. Yi’s views last month, saying that China’s vast currency reserves have become a “big burden” for the country and their continued rise could stoke inflation in the long run.

Mr. Yi also argues that making it easier to move funds across the border could help Chinese diversify their investment, get foreigners to bring more capital into the country and reduce the reserves to a more manageable level. The top leadership has picked him to meet with academics who oppose such moves to try to tamp down their criticism. Mr. Yi tries to assuage them by saying the PBOC can reimpose capital controls if needed, according to people with knowledge of the discussions.

The skeptic camp includes prominent academics Yu Yongding from the Chinese Academy of Social Sciences, and Justin Yifu Lin, the first Chinese to be named World Bank chief economists. Mr. Yi has longstanding ties to them. In 1994, he co-founded an economic think tank with Mr. Lin at Peking University. Mr. Yi also is a leader of the Chinese Group of 50 Economists, a grouping which allows academics and officials to mingle.

“For officials, the G50 is a channel for them to keep contact with the old pals who are still in academics,” says Mr. Yu. “ For economists, it is a good place to get some feeling on policy trends from their old pals who are now holding important positions in government.”

–Lingling Wei and Bob Davis