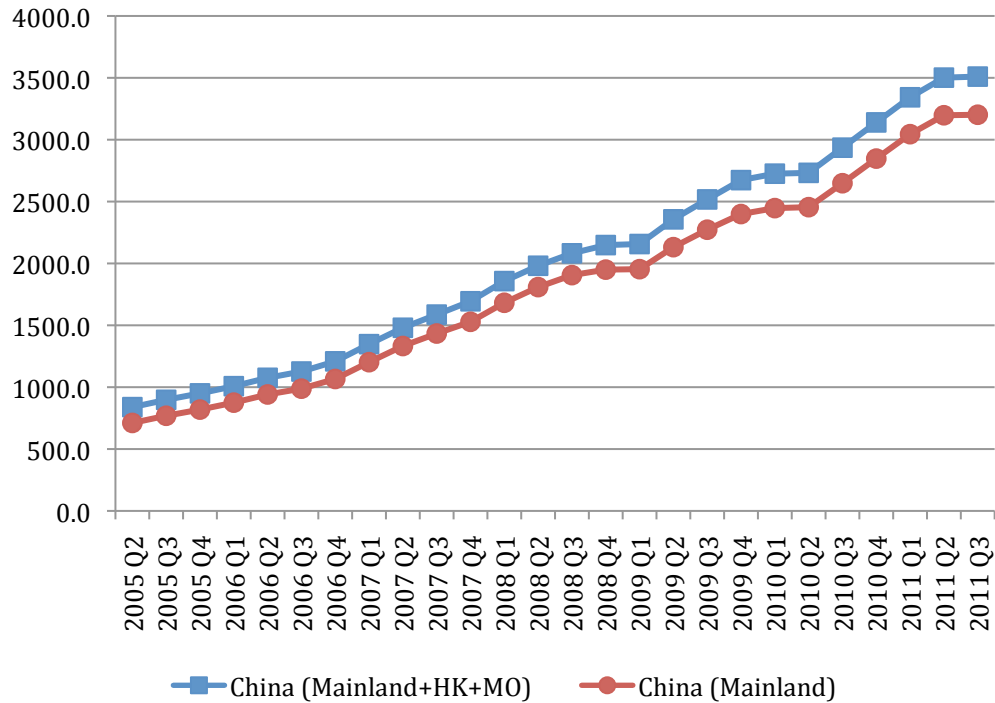


Chinese Foreign Exchange Reserves

(Billions of USD)
2005 Q2 - 2011 Q3



Sources: People's Bank of China; Monetary Authority of Hong Kong; Monetary Authority of Macao

- China's 2.1 percent revaluation of the RMB against the dollar in July 2005 and the subsequent gradual appreciation through July 2008 did little to slow the accumulation of official foreign exchange reserves. This is evidence that the change was too small and too gradual even to begin the process of reversing China's current account imbalance with the world. In addition, other government policies – particularly large amounts of low-interest lending – negated the expected effects of the appreciation.
- In the two years following the effective repeg in July 2008, official reserves rose by more than \$645 billion. China likes to claim credit for the “stability” of the RMB exchange rate with the dollar. In fact, the “stable” RMB had destabilizing effects, as reflected in the huge run-up in additional reserves.
- The latest period of currency appreciation beginning in late June 2010 has resulted in about a 7 percent rise in the nominal value of the RMB. Once again, that “reform” was associated with an acceleration of the rate of increase in official reserves.
- Overall, China's official reserves have quadrupled since the summer of 2005 to an unprecedented 3.2 trillion dollars. This is far in excess of the level that even the world's largest country would need to finance its imports and repay its external debts.
- China's official reserves are *net* of its purchases of raw material and energy deposits around the world and its growing outbound investment under the “going out” strategy. Without a much larger appreciation than China has permitted until now, these increased capital outflows cannot be expected to grow rapidly enough to reduce the huge overhang of hard currencies under China's control.
- Moreover, the official reserves may substantially understate the full extent of hard currencies at China's disposal. When the official reserves of Hong Kong and Macao are included, the total exceeds \$3.5 trillion. If the foreign currency assets of China's sovereign wealth fund, the social security investment fund, commercial bank reserves and individual and corporate accounts are included, the total almost certainly approaches and might surpass \$4 trillion.

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