THE CHALLENGES OF MANAGING CHINA'S HUGE FOREIGN RESERVES: FROM *HUIJIN* TO *CHINA INVESTMENT CORPORATION*

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Executive Summary

1. China's foreign exchange reserves have experienced phenomenal growth on the back of surging trade surpluses and rising foreign investment. It topped US$1.33 trillion by the first half of 2007, more than five times the 2001 figure of US$212 billion.

2. China's foreign reserves far exceed that required for normal monetary operations. Faced with the growing challenge of managing its bulging reserves effectively, China is eager to learn from the experiences of other successful companies and countries including Singapore.

3. The Chinese government decided to make better use of its growing foreign reserves. In December 2003, the government established the *Central Huijin Investment Company* to channel a portion of China's foreign reserves to reform the ailing banking sector by recapitalizing state banks with high Non-Performing Loans.

4. By February 2007, Huijin owns over half of China's financial assets of RMB43.9 trillion (US$6 trillion). *Huijin*'s role and operation is not without controversy, attributed mainly to the turf rivalry between the Ministry of Finance (MOF) and the People's Bank of China (PBOC), China's Central Bank. The initiative to set up *Huijin* came from the State Administration of Foreign Exchange (SAFE). SAFE, though administratively under the State Council, belongs to the bureaucratic network (*xitong*) of the PBOC.

5. On the one hand, the PBOC has always maintained that *Huijin* has been instrumental in facilitating banking sector reforms and eventually helping these banks list on the Hong Kong Stock Exchange. On the other hand, the MOF has asserted that by investing in domestic banks and other financial institutions, and getting them to list overseas, *Huijin* has accumulated even more foreign exchange reserves and contributed to excess liquidity within China.

6. The top policy makers in China have created another body to undertake a coherent and comprehensive approach to better oversee the management of its domestic financial assets and foreign exchange reserves overseas.

7. In May 2007, a new agency called the *China Investment Company* (*CIC*) had acquired a minority equity stake in Blackstone, a leading global asset and financial company. The acquisition has raised overseas concerns that this could signal a bout of aggressive purchasing of foreign equities abroad, resulting in the Chinese government wielding a controlling and unhealthy influence over major companies worldwide.

8. Rather than stoke these fears, the Chinese government is likely to proceed cautiously. Its initial preoccupation is to expose its personnel to the technology and the know-how of managing huge sums of money particularly in the area of risk management and to seek a reasonable return.

9. Because of its G (i.e. government) nature, the *CIC* can be expected to adopt a low-key approach to carrying out its domestic and overseas operations. China will try to refrain from treading on the political sensitivities of foreign governments against the potential negative impact of sovereign wealth funds. The lessons from the abortive attempt by the state-owned China National Offshore Oil Corporation to acquire Unocal two years ago have not been lost on China.