The Threat of Outflows of Short-term Capital amid Continuing Economic Slowdown

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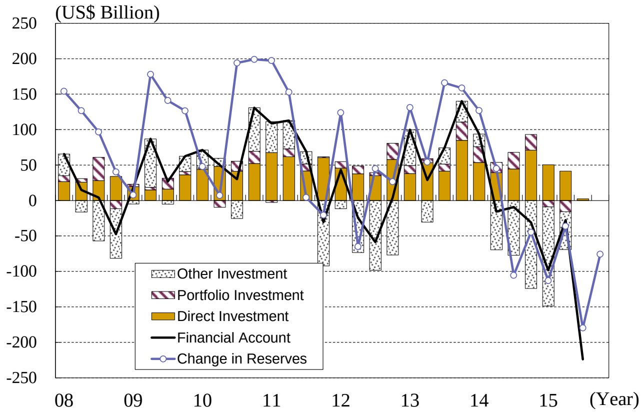
In China, cautions over capital outflows have grown amid the continuing economic slowdown. The financial account in the July-Sept. quarter registered a net outflow of US$223.9 billion, while the foreign exchange reserve outstanding decreased by US$87.2 billion in November as compared to October, recording the third largest drop ever. Available breakdowns for the financial account up till April-June period showed that the outflow was striking in “Other Investments” which mostly are bank loans (Chart 1). It is assumed that amid the continuing economic deceleration, foreign banks decreased their extension of credit to China due to deteriorating corporate profits and adjustments in the real estate market. The statistics of the Bank for International Settlement (BIS), as of June 2016, has shown that the short-term credit (with maturities less than one year) to China by foreign institutions, which accounts for about 80% of the total credit, is in a trend of decrease from its peak in June 2014. Factors for a decrease of foreign exchange reserves may include (i) the intervention by the PBOC to alleviate the pressures of depreciation of the Chinese Yuan, and (ii) impact of decreasing dollar base valuation of non-dollar assets like the Euro and the Japanese Yen.*

In addition, negative figures in the category of “Errors and Omissions” in the balance of payments statistics have been increasing, suggesting a possibility of unrecorded outflows of short-term capitals through unofficial routes. One such unofficial route is the possibility of an overstatement of Chinese imports from Hong Kong. Since 2014, the gap has been widening between China’s imports from Hong Kong (Chinese statistics) and Hong Kong’s exports to China (Hong Kong statistics), which should essentially move together, showing that Chinese imports from Hong Kong have been increasing by two digits recently while the Hong Kong’s exports to China have been decreasing (Chart 2). With the adoption of the RMB in the currency basket of the SDR decided by the IMF in November 2015 (formal incorporation in October 2016), buying demands for the RMB will increase in the longer run reflecting the move for incorporation of the RMB in the foreign exchange reserves by foreign central banks, but for the moment there will be a continuing pressure for capital outflows against the backdrop of deceleration of the Chinese economy and persistent anticipation of a fall of RMB exchange rates, careful attention will be needed.

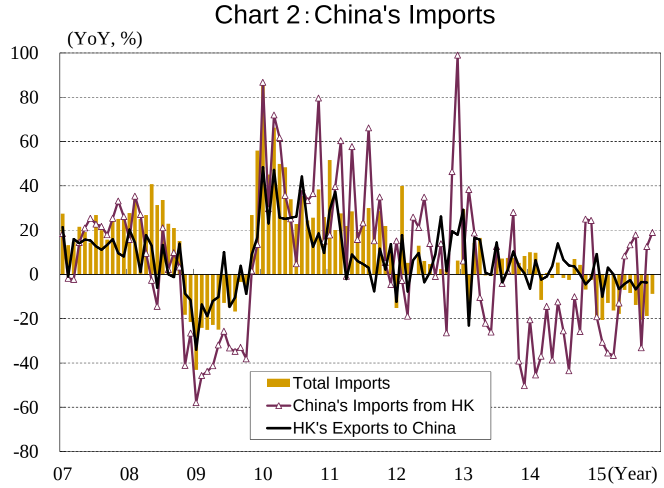
(*)As the composition of China’s foreign exchange reserves are not published, estimations based upon IMF’s data on the world’s foreign exchange reserves ratio (U.S. Dollar: 63.8%, Euro: 20.5%, Pound: 4.7%, Japanese Yen: 3.8%, Canadian Dollar: 1.9%, Australian Dollar: 1.9%) shows that among the decrease of China’s reserves of US$550 billion from its peak in June 2014 to November 2015, a bit less than 20% can be accounted for change in the exchange rates.

Chart 1 : China's Financial Account and Reserves



(Notes) 1. Financial account excludes change in reserves.
2. Change in reserves refers to the difference betwen the end of quarters.
The latest figure is for November.
(Source)Compiled by ERO of BTMU based on the data from SAFE.

Chart 2 : China's Imports



(Source) Compiled by ERO of BTMU based on the data from China General Administration of Customs and Hong Kong Census and Statistics Department