

5/26/2009 7:12:31 AM

Repeat

China Worried About Dlr But Better Than Alternatives

-- Repeating Story Which Originally Ran Earlier Tuesday

BEIJING (MNI) - The Chinese government is concerned about the recent fall in the dollar's value but sees no viable alternative in the global economy sources familiar with the thinking behind Beijing's foreign exchange reserve allocation said.

They were speaking in the wake of the dollar sell-off at the end of last week which followed Standard & Poor's decision to downgrade its outlook for the U.K to negative from stable.

"Of course the government has been worried about the recent sharp falls in the US dollar" said a source familiar with Beijing's thinking.

But there have been no fundamental changes in China's highly-conservative approach to foreign exchange reserve management whatever concerns the government may have about the Obama Administration's reflationary response to the global financial crisis.

And for all the talk of a "dollar trap" that China can't get out of owing to the size of its reserves the greenback is still considered the best option in the currency markets given the dollar's resilience in recent months as well as the relative attraction of longer-term U.S. economic fundamentals.

"According to exchange rate trends the euro sterling and yen are all high-risk currencies where the dollar has been relatively safe" said a person familiar with discussions within the State Administration of Foreign Exchange who asked that his name not be published.

China's dollar addiction isn't simply a reflection of the country's trade flows though the vast majority of its trade is invoiced in that currency.

And officials have acknowledged that China's foreign exchange reserves -- at \$1.953 trillion at last official count -- are simply too large to meaningfully hedge without spooking the currency markets.

But Beijing has also long insisted that the three principles of its foreign exchange reserve management strategy are "safety liquidity and profitability" -- and strictly in that order.

Although the euro is the closest contender in the currency stakes -- and has been estimated to account for around 20% of China's foreign exchange holdings -- sources said that Beijing is attracted to the dollar's liquidity and the role that it has played in the global monetary system since 1945 whatever its flaws.

The euro's popularity is hurt by Beijing's perception that eurozone

policy-making lacks the responsiveness flexibility and aggression of Washington sources said.

"The eurozone is very rigid and conservative" said a source familiar with the thinking at the State Council China's cabinet. "It is one of the reasons why China hasn't embraced the euro."

Hopes that the European Union would act to counterbalance the overwhelming political and military heft of the U.S. have also been disappointed.

The European Council on Foreign Relations noted in a report last month that internal divisions in Europe mean that it is treated with "diplomatic contempt" by China even though it is the country's biggest trading partner.

"We're in a period of global financial crisis but the U.S. is still technologically and militarily very powerful -- that's the strength of the dollar" said the source familiar with discussions in the State Council.

In fact despite ongoing concerns about China's dollar exposure and a few well-publicized musings about theoretical alternatives the government has pretty much stated its love publicly.

High-profile comments by Premier Wen Jiabao about the safety of dollar assets and a proposal by People's Bank of China Governor Zhou Xiaochuan to replace the greenback may have dominated headlines in recent weeks.

But they only served to drown out unprecedented and perhaps more revealing comments from Zhou's deputy SAFE Director Hu Xiaolian which were made at a press conference in late March ahead of the G20 meetings in London.

Hu said that China's Treasury investments are an important part of its foreign exchange reserve management strategy that it invests for the long-term and that under normal circumstances they carry very little credit risk.

While China has been alarmed at Washington's response to the global crisis it has also limited its demands on U.S. officials to ensuring that the floods of liquidity unleashed to reflate the U.S. economy are reined back in as fast as possible when the recovery kicks in Market News International understands.

China will continue to insist that the U.S. take quick control of liquidity conditions in high-level discussions with their Washington counterparts the source familiar with SAFE discussions said.

(Timothy Geithner will be in China for meetings from May 31 until June 2 for his first visit here as Treasury secretary.)

But China's reliance on the dollar as part of its foreign exchange allocation strategy is set to continue.

Standard Chartered Bank estimates that China's holdings of U.S. dollars account for 82% -- or \$1.56 trillion -- of its official foreign exchange assets once third-party buying is taken into account.

That's the highest yet of an estimate usually ranged between two-thirds and three-quarters of overall reserves.

China may be tinkering with the composition and duration of its dollar portfolio as it has constantly this decade but it is certainly not reducing the size.

"Although bulk buying of Treasuries has ended China is not reducing its stock of US securities" Standard Chartered said in a report earlier this month.

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