

People's Bank of China

The most significant event in China's reserve management in 2007 was the establishment of a new sovereign wealth fund, the China Investment Corporation (CIC), officially unveiled in late September. The CIC reports directly to the cabinet, but the Ministry of Finance plays a leading role in the CIC with Lou Jiwei, a former vice-minister of finance, taking over its chairmanship. The leadership group, which also includes top officials from the People's Bank of China and other ministries, is responsible for making decisions on how to deploy the CIC's \$200 billion – the initial allocation from China's vast \$1.4 trillion reserves pool.

Until the creation of the CIC, the State Administration of Foreign Exchange (SAFE), controlled by the central bank, managed all of China's reserve assets. The purpose of setting up a separate institution was two fold. First to alleviate the macroeconomic pressures building up on the central bank as a result of the excessive liquidity in the domestic market, and, secondly and more importantly, to achieve diversification and higher yields from Beijing's ever-growing reserves.

Despite this mandate to improve returns, much of the funds allocated to CIC have been earmarked. One-third of its capital has to be used to incorporate the Central Huijin company (hereafter Huijin), a former investment arm of the People's Bank and its policy vehicle to reform the banking and securities sectors. A second third has been set aside for Huijin to recapitalise two state banks before expected public listings overseas in 2008. This includes a \$20 billion injection into the State Development Bank on 31 December 2007 and the pending recapitalisation of the Agricultural Bank of China on a much larger scale.

To date, there seems to be no clear investment strategy drafted for the remaining third part of the fund, roughly \$70 billion, which has been parked in very short-term money market instruments. This may be partly due to the disappointing results from the CIC's first action: a \$3 billion stake in Blackstone Group, which lost one-quarter of its value drawing fierce criticisms at home from experts as well as the general public. The CIC was also caught between a series of domestic and international pressures. With the renminbi appreciating at an annual average of 5% and the one-year treasury bond paying 4%, the fund's renminbi-denominated yields have to be higher than 6% to satisfy the government. At the same time, overseas investments by sovereign funds are under increasing political scrutiny from the United States and the European Union.