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## China, new financial superpower ...

Posted on Monday, August 3rd, 2009

By **bsetser**

One of the biggest economic and political stories of this decade has been China's emergence as the world's biggest creditor country. At least in a 'flow' sense. China's current account surplus is now the world's largest – and its government easily tops a “reserve and sovereign wealth fund” growth league table. The growth in China's foreign assets at the peak of the oil boom – back when oil was well above \$100 a barrel – topped the growth in the foreign assets of all the oil-exporting governments. Things have tamed down a bit – but China still is adding more to its reserves than anyone else.

Yet China is in a lot of ways an unusual creditor, for three reasons:

One, China is still a very poor country. It isn't obvious why it makes sense for China to be financing other countries' development rather than its own. That I suspect is part of the reason why China's government seems so concerned about the risk of losses on its foreign assets.

Two, almost all outflows from China come from China's government. Private investors generally have wanted to move money into China at China's current exchange rate. The large role of the state in managing China's capital outflows differentiates China from many leading creditor countries, and especially the US and the UK. Of course, the US government organized large loans to help Europe reconstruct in the 1940s and early 1950s, and thus the US government played a key role recycling the United States current account surplus during this period. But later in the 1950s and in the 1960s, the capital outflows that offset the United States current account surplus (and reserve-related inflows) largely came from private US individuals and firms. And back in the nineteenth century, private British investors were the main financiers of places like Argentina, Australia and the United States. We now live in a market-based global financial system where the biggest single actor is a state.

Three, unlike many past creditors, China doesn't lend to the world in its own currency. It rather lends in the currencies of the “borrowing” countries – whether the US dollar, the euro, the British pound or the Australian dollar. That too is a change from historical norms. Many creditor countries have wanted debtors to borrow in the currency of the creditor country. To be sure, that didn't always work out: it makes outright default more likely (ask those who lent to Latin American countries back in the twentieth century ... ). But it did offer creditors a measure of protection against depreciation of the debtor's currency.

This system was basically stable for the past few years – though not without its tensions. Now though there are growing voices calling for change.

China seems to be inching toward the position that those countries borrowing its funds should

start to take on some of the risks that China's government now assumes. The basic idea is simple: China keeps its lending, but gets a better renminbi returns while taking less (currency) risk. That, though, would be a fundamental change in the current international financial system. And it isn't quite clear how China can change its external profile so long as it wants above all to maintain a peg to the dollar at a level that requires sustained intervention – and a controlled capital account.

Some of China's borrowers, by contrast, are arguing that maybe China shouldn't be quite so keen to lend the world quite so much ...

Makes for an interesting world.

This entry was posted on Monday, August 3rd, 2009 at 10:47 am and is filed under [China](#), [U.S. trade deficit and external debt](#), [emerging economies](#). You can follow any responses to this entry through the [RSS 2.0 feed](#). You can [leave a response](#), or [trackback](#) from your own site.

## 49 Responses to “China, new financial superpower ...”

August 3rd, 2009 at 11:08 am

### 1. **Cedric Regula** responds:

Dollar Update

Today seems like a good day to check up on how the greenback is doing.

This is the first day since last Sept. that the dollar index seems happy staying below 78.

[http://quotes.ino.com/chart/?s=NYBOT\\_DX](http://quotes.ino.com/chart/?s=NYBOT_DX)

August 3rd, 2009 at 12:56 pm

### 2. **FollowTheMoney** responds:

well put brad. aside internal consumption drivers, the RMB will need to float freely.

i'm more worried that a flight out of u.s. dollar denominated assets could occur sooner than most expect as the world begins to decouple and emergin players provide stability.

Unfortunately in my view, it seems dollar devaluation at this point is in the cards. It's not hard to argue that the Fed has decided to inflate instead of restructure.

August 3rd, 2009 at 1:01 pm

### 3. **FollowTheMoney** responds:

i would also have to argue, that the Fed/Treasury is in a way really testing china's statements on “dollar stability”.

So many times China has warned us not to devalue it's investment, however what can China really do?

As dollar continues to lose purchasing power China will have to make a decision. I call China “Bluff”. No matter if the dollar lost another 25% vs. Gold would China pull the trigger. They cannot un-peg.....yet.

August 3rd, 2009 at 1:04 pm

### 4. **jonathan** responds:

Do Chinese bankers read your blog?

August 3rd, 2009 at 1:18 pm

### 5. **Yoda** responds:

China doesnt need to unpeg. it will just shrink export to USA, increase export to rest of the world, or increase domestic consumption, as it should be. China will have to stop importing inflation to itself. with declining dollar and higher tax, USA will import less and produce less, high inflation is to stay in USA.

August 3rd, 2009 at 1:36 pm

### 6. **Cedric Regula** responds: