

# On the financial crisis on China's foreign exchange reserves and Countermeasures

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**Abstract.** This paper takes the global financial crisis as the background; to explore the impact of the crisis on China's foreign exchange reserves, as well as the risks in the financial crisis, and identify measures to address the financial crisis.

**Keywords:** financial crisis; foreign exchange reserves; influence

## 1. Introduction

Foreign exchange reserves of a country is one important component of international reserves held by a country's monetary authorities, to cover the balance of payments deficit, maintaining a stable national currency exchange rate as a generally accepted international assets. In recent years, China's foreign exchange reserves exponentially increasing trend. Significant increase in foreign exchange reserves to enhance China's comprehensive national strength and international status, and enhance China's ability to withstand the international financial risks, but the high foreign exchange reserves also bring some of China's economic impact and adverse effects. U.S. and EU financial crisis a large number of issuing bonds, notes depreciated value of foreign currency reserve assets decreased, how to reduce the financial crisis on the impact of foreign currency reserve assets of this study is the reality.

## 2. Financial crisis on China's foreign exchange reserves

Ideas in the investment management of foreign exchange reserves, the country has always stressed that the safety management of foreign exchange reserves and liquidity, which has to a certain extent, the decision of China's foreign exchange reserves will invest primarily in international markets with higher bond credit rating . But for the specific composition of China's foreign exchange reserves, we can some of the data by foreign institutions, to conduct a rough estimate as follows: 70% of U.S. dollar assets, 15% -20% of the euro assets, 8% -10% of the assets and the yen 5% of the sterling and other assets. Clearly, China's foreign currency reserve assets in dollar-denominated assets in the possession of most, it has also become China's reserve assets in the crisis facing one of the reasons great risk of depreciation.

Not only that, a lot of investment in U.S. Treasuries and agency debt, and gave us a potential liquidity problems. If China really experiencing enormous economic crisis that requires large-scale selling by U.S. Treasury and agency debt to be exchanged for cash, the move will lead to a corresponding sharp decline in market price of debt to China itself, but also would be difficult to get out . This time of financial crisis, China's foreign exchange reserves of the inherent problems of the more obvious it. Overall, the financial crisis on the impact of foreign exchange reserves can be summarized as the following key aspects

- The risk of serious shrinkage for the value of foreign exchange reserves.

The financial crisis for the book value of the impact of foreign exchange reserves are twofold: first, the crisis makes the U.S. economy fell into the plight of a small depreciation of the dollar increased the pressure further, which led directly to the U.S. dollar assets as the main form of foreign exchange reserves in China

faces enormous exchange rate risks; Second, with the further spread of the crisis, the U.S. government passed the 700 billion U.S. dollars for this huge bailout plan, but such a huge scale of the flows must be passed the way the issue of new bonds to raise, in order to attract investors, they will improve the newly issued bond yields, which is bound to lead to the market value of bonds issued in the fall. In addition, in order to stabilize the market and stimulate economic recovery, the Fed continue to cut the federal benchmark interest rate, also led the U.S. bond yields remained low, making our holdings of U.S. bond yields declined significantly, so that our country faces huge foreign exchange reserves risk.

- The opportunity cost of foreign exchange reserves are further amplified.

The effect of diminishing marginal returns of capital role, as China's foreign exchange reserves increasing; no doubt about the marginal return itself is constantly decreasing. As mentioned above, China's foreign exchange reserves to buy U.S. Treasuries and other bonds, in fact, yields on these bonds are usually not high, there are indications of the general U.S. Treasury yield is only about 3% and as the financial crisis, the worsening economic situation, the yield may be lower. And domestic investment enterprises in China are usually able to maintain profit margins around 10% levels. We can see that invest in U.S. assets when the debt itself facing a huge risk.

- The risk of foreign exchange reserves, investment losses

As mentioned above, the government has gradually recognized the opportunity cost of foreign exchange reserves, the problem is too high, then gradually began to pursue the idea of changing the profitability of foreign exchange reserves, to actively manage. However, the magnitude of a wide range of financial crisis, leading to the scene of the world economy inadvertently clear, making it difficult, especially on the financial value of the asset value of accurate assessment, and in some extent, to China's foreign exchange reserves investment brings the risk of defeat.

### **3. Measures to improve the management of foreign exchange reserves**

- Government departments change their trade policies, adjust the export tax rebate policy.

From the OLS analysis as mentioned, the Trade Balance is the rapid growth of China's foreign exchange reserves, an important factor. For this to change our trade policies, on the one hand to expand the domestic shortage of supplies, raw materials and some high-tech product imports to meet domestic economic development. On the other hand to reduce and limit the number of raw materials and energy consumption, low-tech goods exports, and enhance the competitiveness of our exports. Reduce and limit some of our energy consumption, low-tech goods exports also our response to the international financial crisis and maintain economic stability and development of important policies, because these commodities are most directly affected by the financial crisis. Optimize the export structure of China, China must adjust export tax rebate policy to restrict the commodity structure of export tax rebates, excessive trade surplus in order to change the status quo and change the status of China's foreign exchange reserves.

- Government departments should keep the RMB exchange rate flexibility, relax ate of exchange controls.

Rapid growth of China's foreign exchange reserves is expected and the RMB exchange rate RMB appreciation is directly related to the lack of flexibility. Only further reform of China's foreign exchange management system and the RMB exchange rate formation mechanism to change the status of China's foreign exchange reserves. Weaken the intensity of the central bank intervention in foreign exchange; adjust the exchange rate formation mechanism, an appropriate increase in the level of the RMB exchange rate, the RMB exchange rate market to determine. Rationalize the operational mechanism of RMB exchange rate, moderate adjust the exchange rate floating rate, the central bank in the foreign exchange market to reduce the number of buy to change the status of China's foreign exchange reserves. In order to address the financial crisis, China's economic structure needs a complete overhaul, and the RMB exchange rate mechanism reform, and promoting China's economic restructuring and development of comprehensive, coordinated, in particular, to help guide resource allocation services and some domestic sectors, so as to promote industrial upgrading, changing economic growth depends on exports . At the same time progressive, willing to exchange settlement system, the initiative to improve the central bank foreign exchange market, the market economy system in the current relaxation of import and export enterprises and individuals the freedom of exchange

settlement and sales, can reduce the pressure on countries to exchange settlement and sales, and easy business and personal freedom to organize activities to further open China's foreign exchange market.

- Implementation of official gold reserves and private possession of gold have both increased.

Although China's gold reserves in 2009 exceeded one thousand tons mark, has reached 1054 tons, which is 1.054 billion grams, but to 1.3 billion people in China to calculate an average of about 0.81 grams per capita is still very low compared; the same time, despite our increasing the absolute number of gold reserves held Jiao impressive, but the gold reserves in the entire reserve is still very low proportion of the assets of less than 2%, but also far below the internationally accepted standard of 10%. At current gold prices, gold reserves of about 300 billion U.S. dollars, accounting for only 1.6% of the proportion of foreign exchange reserves. Foreign exchange reserves, gold reserves in the developed countries in the proportion of generally 40% to 60%. Gold reserves have better mobility and security, to a certain extent, address the financial crisis, exchange rate risk, foreign exchange reserves can also raise the income of a country in terms of gold as a reserve with unlimited authority assets, with the gold country other governments do not have to fear any changes made to the gold value and the decision to change conditions of use of gold. View of the gold reserves in a stable national economy, curb inflation and improve the international credit and so has a special role, our country should increase its gold reserves. The government should allow part of the gold reserves follow into private reserves. "The gold to the common people" can not only ease the pressure on foreign reserves, can also attract private investment.

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