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China's Central bank Governor Zhou Xiaochuan said last month after the nation reported slower-than-forecast first-quarter expansion that China needs to sacrifice short-term economic growth for structural adjustments. Photographer: Nelson Ching/Bloomberg

Bloomberg News

China Names Yuan Convertibility Plan Among This Year's Goals (2)

By Bloomberg News

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China signaled it will propose plans this year to allow freer flows of its currency in and out of the nation as part of measures to loosen control over the yuan and interest rates.

The plan on yuan capital-account convertibility will also include a way to let individuals make overseas investments, the State Council said in a statement yesterday after a meeting led by Premier Li Keqiang on the focus of economic reforms in 2013. Other measures include improving controls on risks from local-government debt, expanding trials of value-added taxes on companies and pushing forward changes to the country's household-registration system.

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Future changes may include raising or removing quotas on foreign investment in the nation's bond and stock markets and giving Chinese companies more freedom to borrow overseas, said Chen Bingcai, a former official with the nation's foreign-exchange regulator. Li in March pledged to open the economy to more market forces and strip power from the government as part of efforts to restructure growth.

"The general principle of the opening-up is to be gradual, starting from long-term investment to short-term capital flows and from a quota-management system to a free flow of money," said Chen, now a Beijing-based researcher with the Chinese Academy of Governance.

The State Council statement didn't give additional details on the capital-account plan.

Interest Rates

A March statement by the State Council also said the nation would roll out measures to promote interest-rate and exchange-rate liberalization this year. That statement didn't mention a plan for capital-account convertibility.

China needs to sacrifice short-term economic growth for structural adjustments, central bank Governor Zhou Xiaochuan said last month after the nation reported slower-than-forecast first-quarter expansion.

"It's a positive sign that the new government under Li Keqiang is trying to boost growth by reform instead of launching fiscal stimulus," Shen Jianguang, chief Asia economist at Mizuho Securities Asia Ltd. in Hong Kong, said by telephone. The goal of a feasible plan for capital-account convertibility shows that the "reform ideas promoted by Zhou Xiaochuan have received endorsement from the cabinet," he said.

'Favorable Conditions'

People's Bank of China Deputy Governor Yi Gang said last month there were a "lot of favorable conditions that are suitable for further liberalization" of the capital account. Yi said April 17 that China will widen the trading band for the yuan "in the near future," after doubling it in April 2012.

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About 80 percent of capital-account items listed by the International Monetary Fund are convertible or partially convertible in China, Yi said. Conditions for the opening up of the capital account include “relatively good” economic fundamentals, sound public finance and banks, and a flexible exchange rate, he said.

In January, the central bank said it would proactively prepare for the trial of its qualified domestic individual investor program, known as QDII2. The government started the QDII program in 2006, allowing Chinese individuals to buy securities in overseas markets through asset managers and funds.

The yuan advanced 0.14 percent to 6.1581 per dollar as of 11:58 a.m. in Shanghai today. It fell 0.18 percent yesterday, the steepest slide this year, after China's foreign-exchange regulator said it would step up scrutiny of cash transfers from abroad by companies and banks.

Economic Growth

China reported economic growth of 7.7 percent for the first quarter, trailing the 8 percent median forecast in a Bloomberg News survey and the 7.9 percent pace for the last three months of 2012. Policy makers set in March a target for expansion this year of 7.5 percent.

“China's growth outlook for 2013 to 2014 is more convincing than that of most other countries and interest rates are substantially higher than in high-income countries,” Royal Bank of Scotland Group Plc economists led by Louis Kuijs wrote in a note dated yesterday. “This should keep net financial inflows positive, despite efforts by the government to stem them.”

China's financial and capital account surplus was \$101.8 billion in the first quarter, the most since 2010 and almost double the \$56.1 billion reported for the same period of 2012, official data show.

Inflow Sign

Yuan positions at Chinese financial institutions stemming from foreign-exchange transactions, a gauge of cross-border capital flows, climbed 1.22 trillion yuan (\$198 billion) during the quarter, the third-biggest increase in data going back to 2000. Gains are a sign of inflows and the largest advance was 1.41 trillion yuan in the first three months of 2008, according to data compiled by Bloomberg.

The People's Bank of China raised its daily reference rate for the yuan by 0.05 percent today to 6.2083 per dollar, approaching the record 6.2082 announced on May 2. The fixing, around which the onshore exchange rate can fluctuate a maximum 1 percent, has been raised 1.2 percent so far this year.

"The PBOC's recent willingness to let the exchange rate strengthen is potentially in line with a planned movement toward a more flexible exchange-rate regime," Kuijs said.

The Chinese currency will be fully convertible within five years, while a third of China's trade will be settled in yuan by 2015, HSBC Holdings Plc forecast in a March report.

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