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S&P Global Ratings Answers Questions On China's Tightening Capital Controls

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SINGAPORE (S&P Global Ratings) Feb. 2, 2017--A quandary for China this year is whether tightening capital controls will stem persistent outflows and depreciation pressure on the renminbi or lead to new problems, S&P Global Ratings said today in a report titled, "The Risks Related To China's Capital Controls."

"China's three, unpleasant, options for responding to outflow pressures are to allow for a faster depreciation of the renminbi, further draw down official reserves, or strengthen capital controls. Lately, it seems authorities are leaning more toward capital controls," said Paul Gruenwald, S&P Global Ratings' chief economist for Asia-Pacific.

China has imposed a number of new measures in recent weeks, including caps on large overseas investments, extra layers of red tape for individuals seeking to send money abroad, and tighter requirements on banks' foreign-exchange dealings.

The measures are aimed at limiting the impact of capital outflows, which are at risk of accelerating if the U.S. dollar and interest rates continue to

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strengthen, attracting capital from emerging markets.

"Continued capital flight from China could make funding difficult for some of the riskier Chinese credits we cover, however most entities have prepared for further U.S. dollar strength. For our rated Chinese companies, the share of foreign debt as a percentage of total borrowings has declined to about 22%, from 30% two years ago," said S&P Global Ratings credit analyst Christopher Lee.

Capital outflows and dwindling foreign-exchange reserves also affect Chinese banks' funding bases.

"Declining foreign-exchange reserves drain money supply from China's financial system, which could tighten interbank market liquidity and drive up funding costs for Chinese banks," said S&P Global Ratings credit analyst Qiang Liao.

One relief for China is that its foreign-currency debt is low relative to the country's GDP. As such, S&P Global Ratings sovereign credit analyst Kim Eng Tan believes that China's objective in stemming outbound capital is to improve confidence in the country's economic trajectory.

"By preventing excessive capital outflows, policymakers aim to stabilize sentiment. If Beijing resorted to very heavy measures to support the currency, this objective would not be met. Such actions would worsen rather improve sentiment, so we don't believe Beijing would do anything extreme to support the currency," said Mr. Tan.