China's Foreign Exchange Reserves and China Investment Corporation's Steps towards Diversifying How It Manages Its Portion of Them

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I. Introduction

An essay by People's Bank of China Governor Zhou Xiaochuan published on the Bank's website on 23 March 2009 ("Reform the International Monetary System") has caused a controversy in international financial circles. Without mentioning the US dollar by name, the essay points out the limitations of the current international currency system, where a particular national currency doubles as the international reserve currency, and proposes the creation of a "super-sovereign" reserve currency. In fact, it proposes that the International Monetary Fund's special drawing rights[1] be used for this purpose.

However, the creation of a super-sovereign reserve currency is a long-term undertaking. In the meantime, practical decisions have to be made about how to manage China's foreign exchange reserves proper (held by the People's Bank of China) and the portion managed independently by China Investment Corporation (CIC). In this report we take a look at both China's foreign exchange reserves proper and the portion managed by CIC before considering the steps we expect CIC to take towards diversifying its assets[2]. Of particular interest is the emphasis placed by Prime Minister Wen Jiabao at the 11th meeting of Chinese diplomats in Beijing (17–20 July 2009) on the use of foreign currency in China, the increasing expansion overseas by Chinese companies ("going global"), the need to link this with how China's foreign exchange reserves are managed, and the need to link outward investment and exports[3]. Although it is not clear to us whether "foreign exchange reserves" here refers to those managed by the People's Bank of China or the portion managed by CIC, we think (1)

1 Special drawing rights (SDRs) are international reserve assets created by the International Monetary Fund in 1969 in order to supplement member nations' existing reserve assets and paid out to member nations in proportion to their quotas. Their value depends on a basket (i.e., weighted average) of four major international currencies, and they are used as accounting units by the IMF and a number of international agencies.

2 For further details of the events leading up to CIC's establishment, see Sekine, Eiichi, "*Chuugoku no Gaika Junbi Un'yougaisha no Setsuritsu ni Muketa Ugoki*" (Moves towards Setting Up a Company to Manage China's Foreign Exchange Reserves), Kikan Chuugoku Shihon Shijou Kenkyuu, 2007 Autumn edition, Tokyo Club Foundation for Global Studies (in Japanese).

3 See http://www.china-embassy.or.jp/jpn/xwdt/t574629.htm.

that comments by the prime minister himself that China should consider using its foreign exchange reserves to assist Chinese companies to expand overseas and (2) that making the point to Chinese ambassadors are significant developments in the debate about whether China should diversify the way its foreign exchange reserves are managed.

II. Managing China's foreign exchange reserves: includes equity investment via Hong Kong

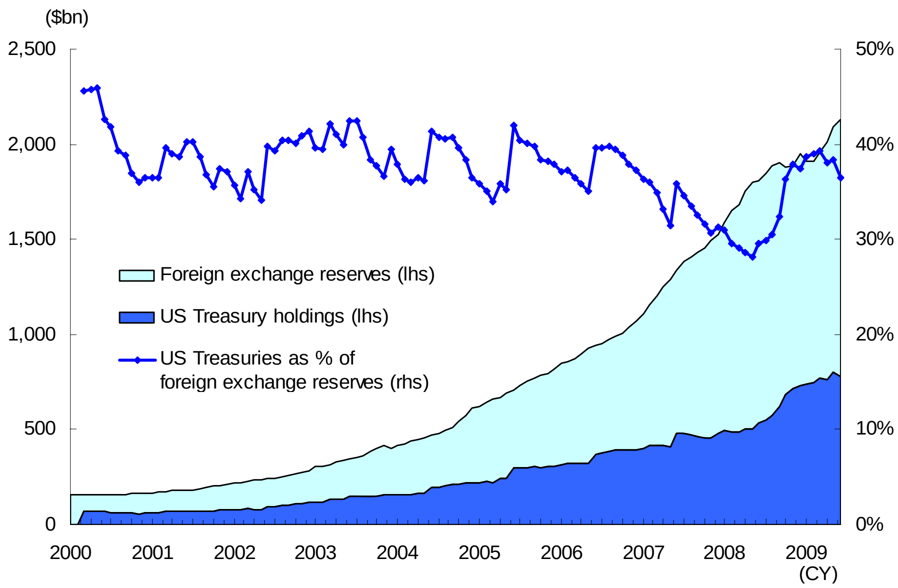
1. Level of China's foreign exchange reserves and investment mainly in US Treasuries

1) China continues to have world's largest foreign exchange reserves

Because of the capital inflows to China as a result of its trade surplus and inward direct investment and the fact that only the People's Bank of China is allowed to hold foreign exchange and intervenes in the foreign exchange market to sell renminbi for foreign currency to ensure that the renminbi does not appreciate, China's foreign exchange reserves are set to increase unless there is a sudden capital outflow.

After overtaking Japan as the world's largest holder of foreign exchange reserves in February 2006, China saw its foreign exchange reserves grow 17.8% year on year to ¥2,131.6bn by end-June 2009, the first time they have topped the ¥2trn mark (Figure 1)[4]. As Japan's foreign exchange reserves totaled ¥1,019.2bn at this time, this development means that China's reserves are now double those of Japan.

Figure 1: China's foreign exchange reserves and holdings of US Treasuries



Note: Data through June 2009.
Source: NICMR, based on CEIC data

[4] According to an announcement by the People's Bank of China on 15 July 2009.

2） China also the world's largest holder of US Treasuries

Currently some 70% of China's foreign exchange reserves are reported to be in US dollars, with most invested in US Treasuries. According to the latest data from the US Treasury Department, Chinese investors were the largest holders of US Treasuries ($776.4bn) as of end-June 2009 (see below for ranking). Japanese investors were the second-largest holders ($711.8bn).

It is perhaps worth mentioning that there was a stir when it was reported that Chinese investors' holdings of US Treasuries as of end-April 2009 had declined by $4.4bn from their level at end-March 2009 ($767.9bn). In response to questions about this, Foreign Ministry spokesperson Qin Gang said (1) that China's use of its foreign exchange reserves to purchase foreign assets, including US Treasuries, was normally dictated by necessity in accordance with three criteria (safety, liquidity and profitability) and (2) that the timing and amount of such purchases were determined by the same criteria. A month later (namely, at end-May 2009) Chinese holdings of US Treasuries were up $38.0bn month on month but were down $25.1bn month on month at end-June. As these statistics include the private sector as well as each country's official reserves, China's foreign exchange reserves cannot be held solely responsible for these fluctuations. While some influential Chinese media took the view that the decline as of end-June could not be interpreted as a sign that the Chinese government had begun to reduce the amount of foreign exchange reserves it held in the form of US Treasuries[5], other media took the view that it was a sign that the Chinese authorities had begun to diversify how they invested those reserves[6].

3） Dilemma of holding US Treasuries

More important, in our view, is what proportion of its foreign exchange reserves China invests in US Treasuries. This figure (for all Chinese holdings of US Treasuries) edged lower, albeit with fluctuations, between 2000 and end-May 2008, when it reached 28.2%. It then trended higher, rising by more than 10ppt in 10 months to reach 39.3% by end-March 2009. It then declined to 36.4% as of end-June 2009 (see above).

What this means for the United States is that, in order to be able to support its financial service and auto industries and fund expenditure on the environment and infrastructure projects, it needs a stable source of demand for Treasury securities. It therefore hopes that China will continue to use its foreign exchange reserves for this purpose. Inasmuch as the United States cannot issue a steady stream of Treasuries without the support of the Chinese government, both new and seasoned issues could be said to be "in hostage" to China.

[5] For example, *Caijing Online*, 18 August 2009.
[6] For example, overseas edition of *People's Daily*, 20 August 2009.

What it means for China, on the other hand, is that, given the short-term difficulty of creating a super-sovereign reserve currency, any decline in the value of US dollar assets will amount to a decline in the value of China's foreign exchange reserves. Also, if China tried to sell its US Treasury holdings in a hurry, it would probably trigger a rise in global long-term interest rates and might attract universal criticism. In that sense, China's own massive foreign exchange reserves could also be said to be "in hostage." We therefore think that the United States and China will ultimately have no alternative but to cooperate. This is also reflected by People's Bank of China Governor Zhou Xiaochuan's comments when he attended the Financial Stability Board meeting in Basel on 28 June 2009 that China manages its foreign exchange reserves in a stable manner and that this is not going to change suddenly. However, we expect China to seek to diversify the way it manages these reserves in the medium to long term. Also, even if China does not dispose of its holdings of US Treasuries, it may diversify them by reducing the proportion of medium- and long-term Treasuries and increasing that of short-term ones.

There was also considerable interest in what China's position would be on its holdings of US Treasuries at the first US-China Strategic Economic Dialogue meeting to be held since President Obama took office. However, it appears that, when the meeting was actually held (on 29–30 July 2009), there was no serious discussion of the dollar's status and stability as a reserve currency or of Chinese exchange rates—only a pretence of cooperation, with the two sides agreeing that the US government would endeavor to encourage more private sector saving and that the Chinese government would endeavor to stimulate domestic demand[7].

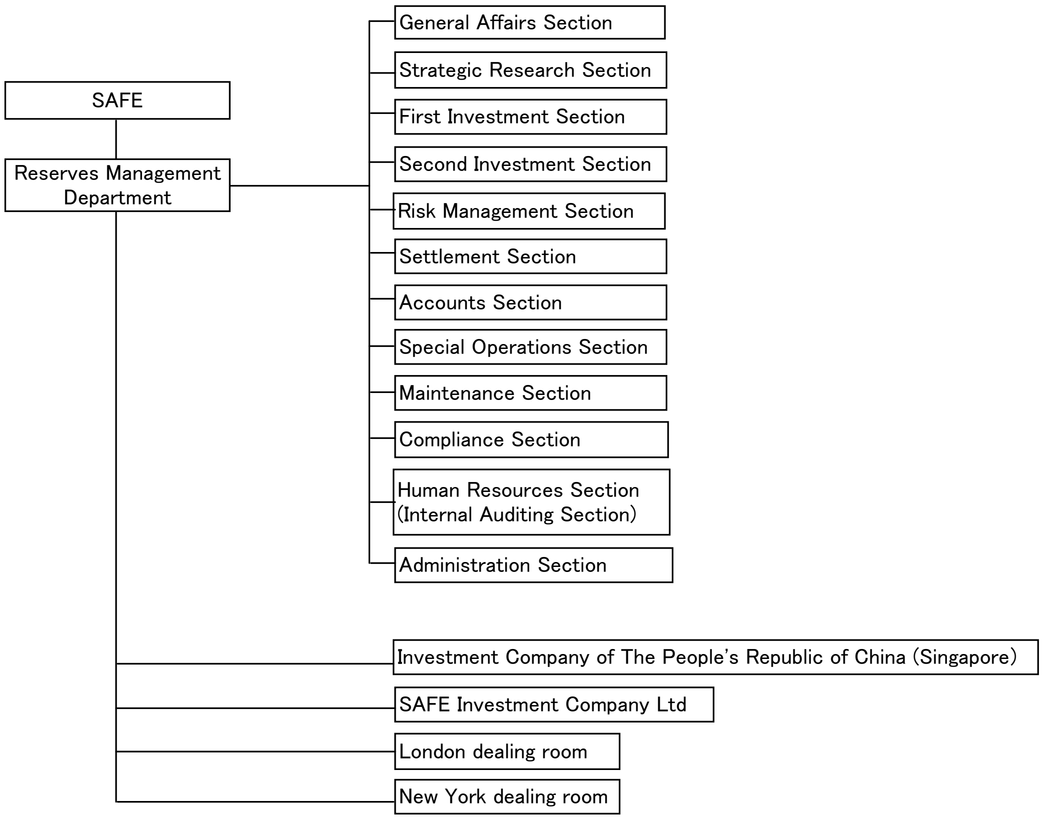
2. China's arrangements for managing its foreign exchange reserves

China's foreign exchange reserves are managed by the State Administration of Foreign Exchange (SAFE), an arm of the People's Bank of China. In July 2009 there was a change at the top of SAFE, with Yi Gang taking over from Hu Xiaolian as director. Mr Gang is also Deputy Governor of the People's Bank of China. The department within SAFE responsible for actually managing the reserves is the Reserves Management Department (Figure 2). This department is run jointly with one of its sections, the Central Foreign Exchange Business Center.

We have deduced from a variety of sources, including the Chinese media, that the Reserves Management Department comprises 12 sections as shown in Figure 2. Investment policy is the responsibility of the Strategic Research Section, while actual investment is the responsibility of the First and Second Investment Sections, with the First Section responsible for US dollar assets and the Second Section for euro and yen assets. The department also has fund management arms overseas: namely, in Singapore, Hong Kong, London and New York. Its Hong Kong arm, Safe Investment Company Limited, is particularly well known. However, there is no published information about the total number of staff employed by the department.

[7] See http://www.treas.gov/press/releases/tg240.htm.

Figure 2: Organizational structure of SAFE's Reserves Management Department



Source: NICMR, based on SAFE and miscellaneous data

3. China's steps towards diversifying how it manages its foreign exchange reserves

1) Buying SDR-denominated bonds

The BRIC countries (Brazil, Russia, India and China) held their first official summit meeting on 16 June 2009 in the Russian city of Yekaterinburg against a background of increasing debate about the future of the international currency system following the aforementioned proposal of People's Bank of China Governor Zhou Xiaochuan for a super-sovereign reserve currency. As of end-June 2009, the BRICs held between them some 46% of the world's foreign exchange reserves and some 32% of US Treasuries on issue, making them a force to be reckoned with (Figure 3).

Although the summit did not result in a detailed agreement on reforming the international currency system, the four countries did agree that emerging economies needed to have a bigger say in international financial affairs. Such moves are also in line with moves to change member countries' contributions to multilateral financial institutions. Although it would not be possible to change contributions to the leading such institution (namely, the International Monetary Fund) overnight, the IMF's board did approve on 1 July 2009 a plan to raise new funds by issuing SDR-denominated bonds in 2009. China was expected to purchase $50bn of the bonds, while Russia and Brazil were each expected to purchase $10bn, making a total of $70bn. All three countries were expected to fund the purchases from their foreign exchange reserves. Since then (on 2 September 2009), China and the IMF have officially agreed that China will purchase $50bn of the bonds. The other BRIC economy, India, announced in September that it would purchase $10bn of the bonds.

Figure 3: BRICs' foreign exchange reserves and US Treasury holdings

Rank	Foreign exchange reserves (end-June 2009)		
	Country	Amount ($100mn)	Share (%)
1	China	21,316	32.64
2	Japan	10,473	16.04
3	Russia	4,134	6.33
4	India	2,654	4.06
5	Korea	2,319	3.55
6	Hong Kong	2,070	3.17
7	Brazil	2,015	3.08
8	Germany	1,915	2.93
9	Switzerland	1,753	2.68
10	Singapore	1,732	2.65
	BRICs	30,119	46.12
	Total	65,312	100.00

Rank	US Treasury (end-June 2009)		
	Country	Amount ($100mn)	Share (%)
1	China	7,764	22.95
2	Japan	7,118	21.04
3	UK	2,140	6.33
4	Brazil	1,398	4.13
5	Russia	1,199	3.54
6	Luxembourg	1,042	3.08
7	Hong Kong	998	2.95
8	Taiwan	770	2.28
9	Switzerland	716	2.12
10	Germany	539	1.59
13	India	393	1.16
	BRICs	10,754	31.79
	Total	33,824	100.00

Note: 1. Foreign exchange reserve data based on universe of 63 countries/regions.
2. Total figure for foreign exchange reserves as of end-March 2009.
Source: NICMR, based on IMF and US Treasury Department data

2) SAFE also invests in individual stocks

Although it has not announced this officially, it appears that SAFE has also started to invest in overseas resource stocks and financial stocks as part of its plans to diversify the way it manages China's foreign exchange reserves.

As leading examples of M&A activity (including cross-border activity), *China M&A Report (2009)*, published by China's Global M&A Research Center[8], cites the People's Bank of China's acquisition of resource stocks such as Total and British Petroleum, and of financial stocks such as the UK financial services company Prudential, confirming that the Bank still held these shares at the beginning of 2009 (Figure 4). Some Chinese take the view that China should use its foreign exchange reserves to acquire overseas oil reserves or build oil storage facilities in China itself. This is the "oil for reserves" argument, according to which China should use its foreign exchange reserves to buy oil-related products—not just securities.

[8] Jointly established by the Institute of World Economics and Politics, Chinese Academy of Social Sciences (CASS), China Europe International Business School (CEIBS), and China M&A Network.

Figure 4: Investment of China's foreign exchange reserves in individual companies by People's Bank of China

Date	Buyer	Target	Details
April 2008	People' Bank of China (SAFE)	Total BP	At the beginning of April 2008 and after several months' work, SAFE acquired a 1.6% stake in Total worth a total of $2.8bn (approx. RMB19.6bn). In mid-April 2008 foreign media reported that SAFE's Hong Kong subsidiary, SAFE Investment Company Ltd, had acquired a 1% share in BP worth some $2bn (approx. RMB14bn). (According to a Bloomberg report of 1 June 2009, the People's Bank of China had acquired 180mn shares, a stake of 0.96%.)
August 2008	People' Bank of China (SAFE)	Prudential	Towards the end of August 2008, the UK media reported that the People's Bank of China, using a nominee account, had acquired a 1% stake in Prudential worth about RMB1.88bn (£134mn), making it one of Prudential's 25 largest shareholders. Prudential is the UK's second-largest insurance company, ranking No. 79 in the Fortune Global 500. (According to a Bloomberg report of 1 May 2009, the People's Bank of China acquired 26mn shares, a 1.03% stake.)

Source: NICMR, based on Global M&A Research Center, *China M&A Report (2009)*, and Bloomberg data

The Chinese government has also been increasing the proportion of its reserves it holds in the form of gold. On 24 April 2009, SAFE's then director, Hu Xiaolian, revealed that China's official gold reserves had increased by 454 tons since 2003 to 1,054 tons. As a result, China's gold reserves are now the sixth-largest of any country/group of countries or international body. This shows that China has continued to diversify how it manages the foreign exchange reserves held by its central bank—and not only by investing in individual stocks.

III. CIC's reorganization

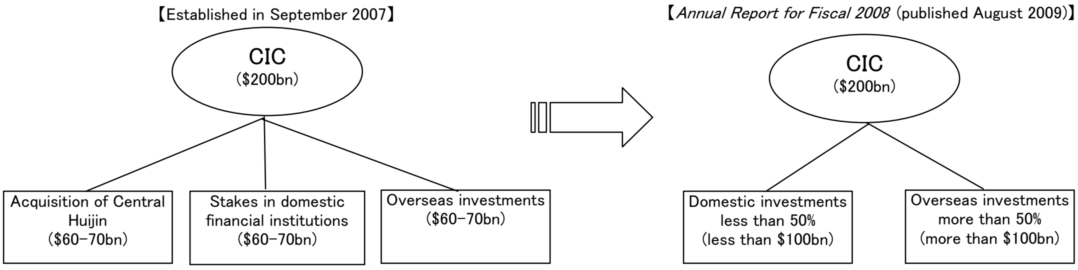
1. Domestic and overseas fund management operations

1) Move from “one-third strategy” to “one-half strategy”

China Investment Corporation (CIC) was set up by order of China's State Council (i.e., cabinet) in September 2007 with Lou Jiwei (formerly Vice-Minister of Finance and Deputy Secretary General of the State Council) as its chairman and Gao Xiqing (formerly Vice-Chairman of the China Securities Regulatory Commission and Vice-Chairman of the National Council for the Social Security Fund) as its president. China's foreign exchange reserves, which are now larger than those of any other country, have hitherto been invested mainly in US dollar assets (namely, US Treasuries). CIC will manage $200bn of these reserves. More specifically, its aim is to maximize long-term risk-adjusted returns in accordance with the principles of (1) separating business and politics, (2) allowing companies to operate independently of the state, and (3) pursuing commercial goals.

When it was established, CIC operated according a "one-third strategy," according to which it aimed to use one third of its capital of $200bn to acquire Central Huijin Investment Ltd ("Central Huijin"), one third to take stakes in domestic Chinese financial institutions, and one third to invest overseas (Figure 5)[9]. However, according to its first annual report (namely, for fiscal 2008, published on 7 August 2009), CIC has invested more than 50% of the $200bn overseas with the rest used to take stakes in domestic Chinese financial institutions via Central Huijin. This amounts to a significant departure from its original asset allocation targets.

Figure 5: CIC's investment policy



Source: NICMR, based on miscellaneous data and CIC's annual report

2) Domestic investments via Central Huijin

Of this, CIC's acquisition of Central Huijin and its stakes in domestic financial institutions constitute its domestic investments. Central Huijin was established in December 2003 as a wholly state-owned company in order to use China's foreign exchange reserves to take stakes in China Construction Bank and Bank of China when they were converted to joint-stock companies. Later it also took a stake in Industrial and Commercial Bank of China (Figure 6). CIC used its paid-up capital to acquire the stakes from Central Huijin, which became the holding company.

Figure 6: Central Huijin's stakes in domestic financial institutions

	Company	Registration	Main business	Shares	Details of Central Huijin's stake		
				Shares on issue (100mn shares)	Acquisition date	Shareholding (100mn shares)	Shareholding (%)
1	China Development Bank	Beijing	Commercial banking	3,000.00	12/31/2007	1,460.92	48.70%
2	Industrial and Commercial Bank of China	Beijing	Commercial banking	3,340.19	4/22/2005	1,182.63	35.41%
3	Agricultural Bank of China	Beijing	Commercial banking	2,600.00	10/29/2008	1,300.00	50.00%
4	Bank of China	Beijing	Commercial banking	2,538.39	12/30/2003	1,714.02	67.52%
5	China Construction Bank	Beijing	Commercial banking	2,336.89	12/30/2003	1,126.88	48.22%
6	China Everbright Bank	Beijing	Commercial banking	282.17	11/30/2007	200.00	70.88%
7	China Reinsurance (Group) Company	Beijing	Reinsurance	361.50	4/11/2007	309.08	85.50%
8	China Jianyin Investment	Beijing	Investment	206.92	9/9/2004	206.92	100.00%
9	China Galaxy Financial Holdings Ltd	Beijing	Financial investment	70.00	7/14/2005	55.00	78.57%
10	Shenyin & Wanguo Securities	Shanghai	Securities	67.16	9/21/2005	25.00	37.23%
11	Guotai Junan Securities	Shanghai	Securities	47.00	10/14/2005	10.00	21.28%

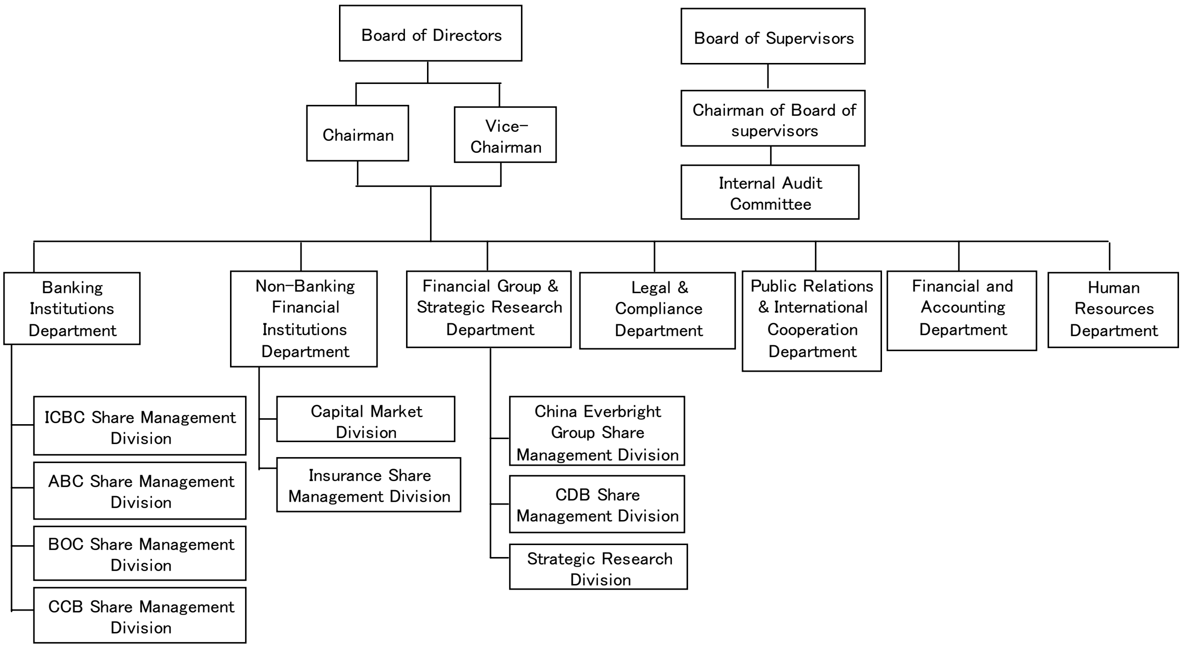
Note: As of 31 December 2008.
Source: NICMR, based on Central Huijin data

9 For further details of the arguments for and against the establishment of CIC, see Sekine, Eiichi, "China Seeks to Actively Invest Foreign Exchange Reserves," Nomura Capital Market Review, Winter 2007, Vol.10, No.4.

Central Huijin's role, as empowered by the State Council, is to take stakes in key state-owned financial institutions, to exercise its rights and fulfill its obligations as an investor on behalf of the state as limited by its stake in each institution, and to maintain and increase the value of state-owned financial assets. Furthermore, it is not allowed to engage in any commercial activity or interfere in the day-to-day business of the key state-owned financial institutions it has invested in.

Also, there are firewalls between CIC's investment activities and Central Huijin's stakes, although some of the two companies' senior positions are occupied by the same persons. Central Huijin has both a board of directors and a board of supervisors (Figure 7). In turn, the board of directors overseas the chairman and vice-chairman, who are responsible for each department's operations.

Figure 7: Central Huijin's organizational structure



Source: NICMR, based on Central Huijin data

Since it was established, CIC has taken stakes in China Everbright Bank (a joint-stock commercial bank) and China Development Bank (a policy bank). Agricultural Bank of China, which was the only one of China's four major state-owned commercial banks not to have converted to a joint-stock company, finally become one on 16 January 2009. With a registered capital of RMB260bn, 50% was acquired by CIC via its Central Huijin subsidiary while the remaining 50% is owned by the Ministry of Finance. Converted at the exchange rate prevailing at the end of 2008, this means that CIC has a stake of about $19bn in Agricultural Bank of China.

2. CIC's overseas investments and investment organization.

1) Trial period from 2007 to 2008

Next, we look at CIC's overseas investments. In May 2007 CIC took a $3bn stake in the US private equity firm Blackstone Group LP (corresponding to 9.9% of the latter's equity securities) (Figure 8). This was then raised to 12.5% in October 2008 by joint agreement.

Figure 8: CIC's overseas investments

Type	Investment	Amount	Date & details
Equity stake	Blackstone	US$3.0bn	Acquired 9.9% of equity securities (in a pre-IPO) in May 2007 Agreed on 16 October 2008 to increase this to 12.5%
	Morgan Stanley	US$6.2bn	Acquired 9.86% ($5.0bn) in December 2007 Maintained 9.86% share by taking additional ($1.2bn) stake in June 2009
	China Railway Group	US$100mn	(Pre-IPO, Hong Kong) November 2007
	VISA	US$100mn	(Pre-IPO) March 2008
	JC Flowers	US$3.2bn	April 2008
	Goodman Group	A$200mn	Announced investment (worth about ?15.0bn) in June
	Teck Resources	US$1.5bn	Announced (17.2%) stake in July 2009
	Diageo	￡221mn	Reported to have taken (1.1%) stake in July 2009. However, also reported that CIC had denied this (Bloomberg reported on 1 July 2009 that 280mn (1.11%) of the shares were registered in the name of the People's Bank of China)
	CITIC Capital	HK$2bn	CITIC Capital's capital increased from HK$3.0bn to HK$5.0bn by means of third-party distribution in July 2009, with CIC taking a HK$2.0bn (40%) stake
External management	European equities, North American equities, Japanese equities, emerging market	n.a.	Started to recruit fund managers in November 2007 Started to invite applications from external fund managers in December 2007
	Bonds		Started to invite applications from external fund managers in January 2008

Source: NICMR, based on CIC data

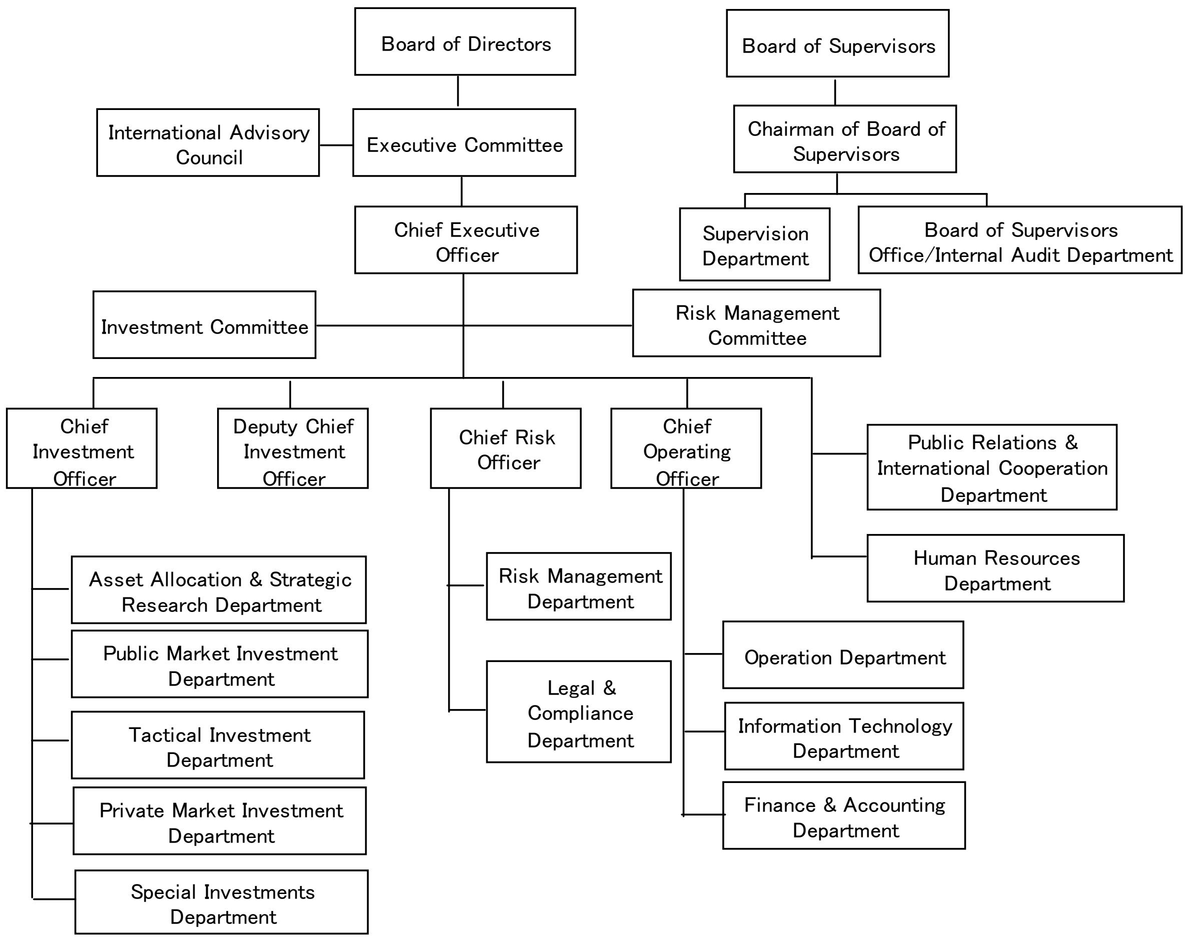
In the second half of 2007, as the global financial crisis deepened, sovereign wealth funds took stakes in a number of US and European financial institutions. CIC was no exception, taking a 9.86% stake in Morgan Stanley in December 2007, which it has maintained by responding to the company's cash call in June 2009. As far as individual stocks are concerned, CIC also took a $100mn stake in China Railway Group when it listed on the Hong Kong Stock Exchange and a similar stake in VISA when it made an initial public offering. As far as private equity is concerned, CIC also has a $3.2bn stake in JC Flowers in addition to its stake in Blackstone. However, it has been reported that after May 2008, with unrealized losses on its existing equity stakes and in the absence of attractive investment opportunities, CIC cashed in most of its overseas investments as the financial crisis deepened. This has since been confirmed by CIC's annual report for fiscal 2008, according to which 87.4% of its global portfolio was in the form of cash at the end of 2008. Of the rest, 9.0% was invested in bonds, 3.2% in equities, and 0.4% in other assets.

According to CIC's annual report, its net profit for 2008 was $23,130mn, its return on equity 6.8%, and its return on investments (namely, its global portfolio) –2.1%. Its total assets amounted to $297.5bn. Like the publication of its annual report, this was the first time for CIC to give figures for its investment performance.

2) April 2009 organizational changes

However, this situation has changed somewhat since the start of 2009. First of all, CIC reorganized its investment departments on 29 April 2009. CIC's benchmark portfolio was divided into equities, bonds, tactical investments, and other investments, and its Equity Investment Department, Fixed Income Investment Department, and Other Investment Department were replaced with four new departments: a Public Market Investment Department, a Tactical Investment Department, a Private Market Investment Department, and a Special Investments Department (Figure 9).

Figure 9: CIC's organizational structure



Source: NICMR, based on CIC data

According to CIC's website and its annual report for fiscal 2008, its Public Market Investment Department is responsible for passive investments in public market equities, bonds, commodities and currencies. The Tactical Investment Department is responsible for achieving absolute returns on in-house and externally managed investments. The Private Market Investment Department is responsible for investing (1) via third-party managers, in limited partnerships, and in pooled investments as well as in (2) real estate and infrastructure. The Special Investments Department is responsible for major long-term investments. Each department is also responsible for recruiting and evaluating fund managers, market research , investment strategy, and portfolio management.

A Strategic Asset Allocation & Research Department is responsible for devising the strategy underlying the four departments' overseas investment. As well as deciding (1) CIC's overall investment strategy and asset allocation, this department is responsible for (2) monitoring overall investment objectives and risk budgeting, (3) research on the main financial markets, sectors and countries, and (4) acting as a secretariat for CIC's asset allocation committee[10].

CIC has 194 staff altogether, 67 of whom work for the aforementioned investment departments (Figure 10). Ten of the 67 are non-Chinese.

Figure 10: Composition of CIC's investment staff

Department	Number of staff	(Breakdown)			
		University degree or higher	Overseas working experience	Overseas study experience	Foreign nationality
Asset Allocation & Strategic Research Department	11	10	5	5	2
Public Market Investment Department	14	14	10	10	1
Tactical Investment Department	9	9	7	9	2
Private Market Investment Department	17	17	12	13	5
Special Investments Department	16	16	13	11	-
Total	67	66	47	48	10

Source: NICMR, based on CIC’s *Annual Report (fiscal 2008)*

3. Resumption of investment activity and recruitment of new staff

A number of measures have been taken since CIC was reorganized to enable it to resume its investment activity (see Figure 8 above). For example, in June 2009 CIC announced that it would take an A$200mn (roughly ¥15bn) stake in the Australian Goodman Group[11]. Similarly, in July 2009 it announced that it was taking a 17.2% (or $1.5bn) stake in the Canadian company Teck Resources. This was CIC's first investment in natural resources. Although there has been considerable interest in CIC's activity in this field, the company's executive vice-president and chief research

10 We have not seen any published information on the Committee's membership, how often it meets, and its powers.

11 See *First Financial Daily*, 17 June 2009.

officer, Wang Jianxi, has emphasized (1) that the company's main aim is financial investment, not politics, and (2) that it is looking for a long-term return from rather than control of the companies it invests in[12]. CIC has also been reported to have taken a stake in the UK drinks manufacturer Diageo[13] and to have responded to a cash call from Hong Kong-based CITIC Capital Holdings[14].

At roughly the same time as this reorganization and the resumption of CIC's investment activities (namely, on 16 June 2009), CIC began to recruit new staff on the basis of its new departments (Figure 11). More specifically, it has been recruiting staff for 33 job categories in a total of 13 departments, including middle and back office departments such as the four reorganized departments. Short lists have already been drawn up, and interviewing began in August. On the careers page of CIC's website, it says: "People are our most valuable asset," and the company is clearly keen to recruit talented staff of different nationalities and from different cultures. It has also been reported that CIC is ready to invest about $6bn in managed account-type hedge funds[15] or $500mn in a Blackstone Group hedge fund[16]. We think the company is eager to recruit staff in order to be able to resume its investment operations as soon as possible following its reorganization.

We expect CIC's 14-member International Advisory Council, which is made up of senior figures from financial authorities, stock exchanges and financial institutions from all over the world, to play an increasingly important role in how CIC operates. Six of the members (including Taizo Nishimuro, President and Chief Executive Officer of the Tokyo Stock Exchange) are from the rest of Asia, five from the Americas, and three from Europe. The Council's first meeting was held on 5 July 2009 in Beijing.

In a recent interview with the *Asahi Shimbun*[17], CIC's president, Gao Xiqing, said that he expected the company to invest about ten times as much new money in 2009 as in 2008 (namely, several tens of billions of dollars) as the global economy bottoms out. Mr Gao said that new overseas investment in 2009 was already well in excess of the $4.8bn invested overseas in 2008. At the same time, he also indicated that CIC was eager to invest in Japan. It will be interesting to see what CIC invests in next.

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12 See *First Financial Daily*, 6 June 2009.

13 According to the *Financial Times*, 20 July 2009, CIC acquired a 1.1% stake in *Diageo* for £221mn, making it the ninth-largest shareholder in the company. However, the *Financial Times*, 22 July 2009, published a denial by CIC. Bloomberg later announced on 1 July 2009 that the People's Bank of China had acquired 28mn (or 1.11%) of the shares.

14 On 20 July Reuters announced that CIC had agreed to acquire 40% of the shares in the Hong Kong subsidiary of CITIC Group, CITIC Capital, for HK$2bn in an initial public offering. This will apparently boost CITIC Capital's paid-up capital by HK$2bn to HK$5bn.

15 See *Caijing Online*, 18 June 2009.

16 See the *New York Times*, 19 June 2009.

17 See the *Asahi Shimbun*, 27 August 2009.

Figure 11: CIC's recruitment campaign (announced on 16 June 2009)

Recruiting department	Category
Asset Allocation & Strategic Research Department	Strategic macroeconomic research
	Strategic public market investment research
	Strategic private market investment research
	Quantitative analysis
Public Market Investment Department	Managing cash and interest-rate products
	Managing bond analysis
	Managing commodity investment
	Managing equity investment portfolios
Tactical Investment Department	Industry analysis
	Managing investment transactions
	Hedge fund analysis
Private Market Investment Department	Private equity investment
	Credit products
	Infrastructure investment
	Real estate investment
Risk Management Department	Assessing investment value and performance
	Assessing credit risk and country risk
Legal & Compliance Department	Legal affairs
	Compliance
Operation Department	Managing investment projects
	Internal controls
Information Technology Department	Developing investment systems
	Data management
Finance & Accounting Department	Investment accounting
	General administration
	Costs and disbursements
Public Relations & International Cooperation Department	Public policy and public relations
	Country-based policies and economic analysis
	International cooperation, high-level interpretation
Human Resources Department	Personnel management
	Internal Communist Party of China administration
Supervision Department	General administration
Board of Supervisors Office/Internal Audit Department	Internal auditing
Total of 13 departments	Total of 33 categories

Source: NICMR, based on CIC data

IV. Conclusion

As China's financial authorities have not always made it clear what their attitude is to how China's foreign exchange reserves should in future be invested, we have no alternative but to infer this from circumstantial evidence such as any changes in China's holdings of US Treasuries. We therefore hope that the Chinese government will make its position on this clearer. An editorial in the overseas edition of the *People's Daily* on 20 August 2009 openly admits that the Chinese government wants to diversify how it invests China's foreign exchange reserves but faces two challenges: (1) the need to assess objectively what composition of its reserves would enable it to maximize profit while minimizing risk, and (2) the need to recruit staff familiar with international rules as soon as possible. Especially with regard to the former (namely, the composition of China's foreign exchange reserves), the editorial points out that China needs to hold a certain proportion in the form of US dollars and the rest in a combination of other currencies (such as the euro, pounds sterling and the Swiss franc) and gold in order to be able to pay China's foreign debts in an emergency—one of the functions of foreign exchange reserves. It also says that the government should consider using China's reserves to help Chinese companies expand overseas, to acquire large-scale infrastructure and advanced technology, to invest in strategic resources and blue-chip companies, to grant loans to other countries, and to acquire real estate and commodities.

Although the *People's Daily* is an organ of the Communist Party of China and its overseas edition is regarded as a means for the CPC to communicate its views to an overseas audience, we do not think that the aforementioned views are necessarily solely those of the CPC. Nonetheless, they may indicate that the different sections of the government are considering various possibilities. We expect the government to continue to consider different options for managing China's foreign exchange reserves.