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Europe's Debt Woes Start to Complicate China's Money Moves

By **KEITH BRADSHER**

HONG KONG — Spreading problems in Europe's sovereign debt markets pose potential challenges for [China](#), which has been stepping up its investments in European government bonds and relies on Europe as its biggest export market.

The turmoil that Europe's difficulty has caused in financial markets already appears to have caused tens of billions of dollars in paper losses in China's foreign exchange reserves. And the problems may complicate the timing of an expected Chinese move to break the informal peg of the Chinese renminbi to [the dollar](#), Chinese and Western economists and bankers said on Thursday.

Yet, officials in Beijing have almost completely avoided public comments and are showing little enthusiasm for playing a direct role in the complex diplomatic and financial negotiations as Greece, Portugal and Spain struggle to respond to downgrades in their sovereign debt ratings. China's role, if any, would probably come via its participation as a big contributor to the [International Monetary Fund](#), economists and bankers say.

Jiang Yu, a Chinese foreign ministry spokeswoman, gave the first official Chinese response during a routine press briefing in Beijing on Thursday afternoon, and it implied China's preference for watching from the sidelines.

"We hope the issue can be resolved satisfactorily and that the affected countries would soon emerge from their difficulties and achieve economic recovery," she said.

With \$2.4 trillion in foreign exchange reserves, China has considerably more cash for any financial rescue than even the I.M.F. But the central bank, the People's Bank of China, which oversees the foreign reserves, has been extremely wary of deploying that money directly as highly visible investments in troubled economies. It mainly refrained from doing so even during the depths of the global [financial crisis](#) in late 2008 and early 2009.

The Chinese government has preferred to work through the I.M.F., which China has tended to regard as a better credit risk and less politically sensitive than many individual countries.

China's share of cash committed to I.M.F. shares, known as its quota, has nearly doubled since the

Asian financial crisis in 1997 and 1998, to \$12.2 billion. The I.M.F. board has approved another increase soon, which would raise China's stake in the multilateral organization to 4 percent from 3.72 percent.

China is already the fourth-largest holder of quota rights at the I.M.F., after the member countries of the [European Union](#), with 32.4 percent; the United States, with 17.1 percent; and an Asian bloc informally led by Japan, with 11.5 percent.

China agreed last September to buy up to \$50 billion worth of bonds issued by the I.M.F. to help the multilateral agency strengthen its lending capacity, in the first such deal done by the I.M.F.

In recognition of China's rising influence, Zhu Min, a deputy governor of the People's Bank of China, was named on Feb. 24 to become the special adviser to the I.M.F.'s managing director, [Dominique Strauss-Kahn](#), and will start work on May 3.

But China has been wary of using its influence publicly, in keeping with its overriding foreign policy principle of seeking a "peaceful rise" in China's role in the world.

"China is unlikely to take a leading role in defining the terms of the I.M.F.'s assistance program to Greece," said Eswar Prasad, a former head of the China desk at the I.M.F. "It is in China's interest to see the situation in Europe stabilized, as it is their most important export market. And they are likely to get behind whatever amount of assistance and types of conditions the I.M.F. thinks are most likely to achieve that objective."

China closely guards any details on the currency allocation of its reserves. Western bankers estimate that the Chinese reserves are about 70 percent invested in dollar-denominated assets, mainly [Treasury notes](#) and bonds, and 20 to 25 percent invested in euro-denominated assets, with the rest in British pounds, Japanese yen and other currencies.

Chinese officials have been looking for safe ways to invest the country's vast savings overseas, and euro-denominated government bonds had appeared until very recently as an attractive alternative to Treasuries, said Yu Yongding, a former member of the monetary policy committee of the People's Bank of China.

"China needs deep, liquid, safe financial markets," said Mr. Yu, who is the director of world economics and politics at the Chinese Academy of Social Sciences, an advisory body to China's cabinet.

Premier [Wen Jiabao](#) has even voiced public concern in the last year about rising American budget deficits and the ability of the United States to protect the buying power of Chinese money invested in Treasuries.

The People's Bank of China has financed its country's huge foreign reserves by borrowing money

domestically, mainly from the state-owned banking system; the prospect of losses on those reserves has been a sensitive subject that is frequently censored when it pops up in Chinese Internet discussion forums.

But any losses on European investments are likely to be modest, relative to China's overall reserves, barring an actual ripple of defaults across Europe.

The euro has lost a tenth of its value against the dollar in recent weeks. But a tenth of the 20 to 25 percent of the portfolio invested in euros still works out to a loss of only 2 to 2.5 percent on the entire portfolio.

Because the Chinese currency, [the renminbi](#), is informally pegged at about 6.83 to the dollar, [the euro's](#) slump against the dollar has meant a slump against the renminbi as well. This is making Chinese goods more expensive in Europe.

"The slump in the euro has really affected our business, since Europe accounts for 80 percent of our business and we receive euros from our clients," said Wu Xiaozhan, the sales manager of Yiwu Disa Jewelry and Belt Company, a producer of beads and other costume jewelry components in Yiwu City, in east-central China. "These are all long-standing clients, so for the time being we have not considered raising prices or switching to invoicing in another currency. We will just bear the loss for now."

Chinese leaders have been preparing to break the renminbi's link to the dollar, because preserving that link has limited their ability to control speculative bubbles in the Chinese economy. It has also caused them to accumulate enormous foreign exchange reserves through currency market intervention.