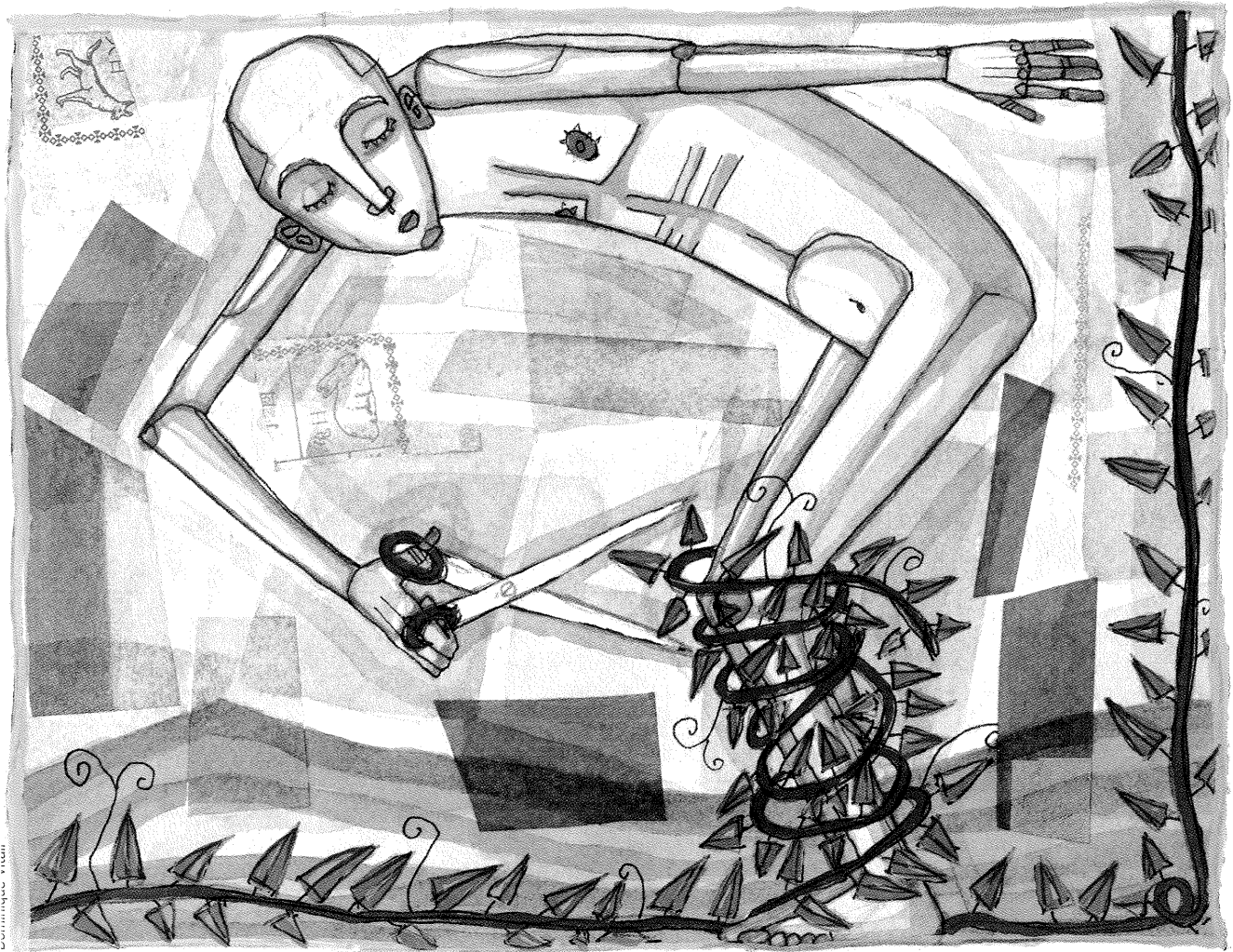


# Chinese Debt Insurance

If China devalues its currency, borrowing in yuan might protect the interests of those investing in the country's infrastructure



**S**OME INVESTORS IN CHINA ARE GETTING A LITTLE nervous. In the wake of the Asian financial meltdown that sent currencies like the Thai baht, the Indonesian rupiah, and the South Korean won plummeting, investors are worried the same thing could happen to the Chinese yuan. To address that risk, they're looking closely at a kind of insurance policy that guards against such a devaluation: financing their mainland investments in the local currency.

New World Development Co., for example—one of Hong Kong's biggest players in China, with \$3.5 billion invested in mainland roads, ports, housing, and power

plants—is now considering plans to borrow in Chinese yuan to finance new projects on the mainland. The move is one sign that corporate Hong Kong—the biggest outside investor in China—is starting to doubt Beijing's repeated promises to maintain the yuan's value. Other Hong Kong-listed companies with investments in China, such as GZI Transport, also are looking to increase yuan-denominated debt.

Their concern is easy to understand. A growing minority of economists say China will have to devalue the yuan—a unit of the country's renminbi currency—within 18 months to pump up its economy, because declines

of more than 50 percent in certain Asian currencies will cut into exports, China's main engine of growth. New World, with one-fifth of its assets in China, is taking the possibility seriously. "We want to take renminbi loans, as there's no foreign exchange risk," says Johnny Chiu, spokesman for New World Infrastructure (NWI), the group's China development project arm. "We won't have to worry about repayment if there were a devaluation in the yuan."

Chiu declined to disclose the company's future borrowing plans, but they could be extensive. Last December, in its most recent venture, NWI signed an agreement to build a \$220-million toll road in the city of Chengdu in central China. The firm may also need to borrow in the next six months if it finalizes contracts to invest in roads and power plants in the northern Chinese provinces of Henan and Shanxi, Chiu says.

According to Chiu, the company's debts as of this February give it a gearing (debt-to-equity ratio) of about 50 percent. In June 1997, NWI's total investment in China was \$950 million. Devaluation of the Chinese yuan would effectively cut income from NWI's projects in China—which generate revenues in yuan—whereas the costs of servicing the company's own foreign currency debt would be unchanged.

That kind of figuring is not unique to NWI. GZI Transport, backed by the government of the southern Chinese city of Guangzhou, has said it, too, plans to hedge its currency exposure when financing mainland road projects. "Our revenue is in renminbi, so it makes sense for us to borrow as much money in renminbi as possible," says Sophia Yan, an executive director at Guangzhou Investment Co., parent company of GZI. Echoing Chiu's sentiments, she adds, "We want to borrow more in renminbi because there's no currency risk."

Other Hong Kong-listed companies that generate much of their revenue from activities in China and plan to increase yuan debt include Guangdong Investment, Road King Infrastructure, and Sichuan Expressway, reports Hong Kong's *Ming Pao Daily News*. "China will be forced to devalue the renminbi by 30–40 percent within 18 months," says David Roche, president of Independent

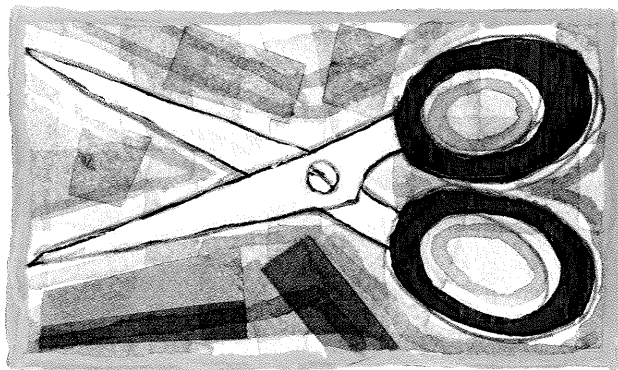
Strategy, a London consultancy.

The yuan was valued at about 8.3 to the dollar in late February and doesn't trade

freely at present. Under certain circumstances, that could put China in the same bind that confronted other governments throughout Asia starting last summer: whether to try to protect the value of the currency or whether to weaken the currency to shore up exports at the risk of setting off a free fall that could rock banks and ignite inflation. A major consideration in China's decision involves the country's ability to carry out plans to shut down money-losing, state-owned companies it can no longer

afford to subsidize while keeping its economy growing fast enough to create jobs for the millions of people thrown out of work by such closings.

For the plan to work and for China to be able to keep unemployment down and maintain social stability, the country needs to generate real, after-inflation economic growth of 11 percent a year, according to Independent Strategy research. But Independent Strategy estimates that real growth in 1998 will be only about 4.6 percent,



most of it coming from exports.

China's strong currency—it was one of just two currencies in the world to strengthen against the dollar last year, the other, surprisingly, being the Egyptian pound—is making Chinese businesses increasingly vulnerable to international competitors whose own clobbered currencies allow them to sell goods abroad cheaply. Companies such as Baoshan Iron & Steel Corp., Jiangxi Copper Co., and Jilin Chemical Industrial Co. are already being squeezed as China's economy expands at its slowest pace since 1991.

China's central bank governor, Dai Xianglong, has said a currency devaluation is "out of the question," but a move to weaken the yuan is preferable to supporting the currency and stifling growth, says Roche. And even without an immediate devaluation, investors in China's infrastructure have reason to look more favorably at yuan-denominated loans. In a move to shore up national growth, China's state-run banks are cutting interest rates, which have come down about 2 percent recently. That makes yuan loans appear more attractive to companies like NWI.

The low-interest yuan-denominated loans available today—and the possibility that a yuan devaluation may soon become a reality—make for a combination that's inclining a growing number of major investors in China to look favorably at borrowing in yuan. Leon Chik, analyst at HSBC James Capel Asia, says simply, "It's a good move."

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## A growing number of economists believe China will have to devalue the yuan