
MONETARY CHANGES IN CHINA

Fruits of the New Currency System

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FAR EASTERN AFFAIRS SERIES

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The issue of this Supplement coincides with the end of a transitional period in China's financial history, during which she has abandoned her silver, and adopted a foreign exchange standard. I was in China when this step was decided on, and had spent the previous six or seven months in a close study of her affairs. These, whilst affording many reasons for hopefulness, were then critical. The latter fact arose from two sets of causes, one political, in which the most disturbing factor was Japan, the other, financial and commercial, comprising a dismaying array of dislocations—an appreciation of the Chinese dollar in relation to external currencies, an adverse balance of payments, a consequent drain of silver from the country with increasingly unstable relations between its silver dollar and its subsidiary copper currency, falling prices and contracting credit, all these factors combining to create a growing lack of confidence, which was to a large extent justified by the strain placed upon the

country's banking system. During the summer and early autumn of 1935 predictions of disaster were rife, and even after November 3, when the decisions which have so largely changed the economic outlook were announced, pessimists remained plentiful. Today, except for a handful of persons who in no circumstances would be hopeful, they have, as the song says, packed up their troubles in their old kit-bags, and disappeared.

Two Difficulties

Indeed, in describing the present situation one is conscious, so favourable are most of the indices, of the risk of painting too optimistic a picture. It may be as well, therefore, to begin by noting certain factors which cannot yet be said to have lost their power to spoil the outlook. One is still Japan; a second is General Chiang Kai-shek's position in relation to the Communists in the North West, whilst a third, largely the consequence of these two, is the continuance of an unbalanced budget.

To examine the first two at any length would be out of place in a supplement of

this kind. They cannot, on the other hand, be dismissed by saying that they bear the same kind of relationship to China's economic outlook as rearmament and the possibility of war bear to our own. Of the first factor it may, indeed, be said that the nature of the relationship is the same; yet its degree is at once closer and more acute. This arises in part from the directness and emphasis with which Japan has come to impinge upon China—a fact responsible in the latter country for an increasingly inflammable psychology; in part from the relationship of the second factor, Communism, to China's agrarian difficulties, and in part from the composition of the Chinese Government. In this the civilian element, consisting mainly of a single party numerically small, is less important than its military element, comprising a large variety of personal relationships cemented, in differing degrees of reliability, by loyalty to a single man. It is upon these that the stability of the State depends, though civilian administrators are becoming increasingly important.

China's annual accounts illustrate several of these facts very clearly.

	Payments (Million \$)		
	1933	1934	1935
<i>Total</i>	699	836	94
Military	321	373	388
Loan Service	210	244	237
Civil Expenses	77	98	230

It is primarily military expenditure which complicates the task of balancing the budget, yet as long as China believes herself to be menaced by Japan, and is at the same time confronted by an internal military problem, military expenditure is unlikely to decrease.

Official figures show annual deficits (in millions of dollars) as follows:—

Year ending June 30	Net total Payments	Net total Re-venue	Deficit	Deficit as % of Payments
1931	774	557	217	28
1932	749	619	130	17.4
1933	699	613	86	12.2
1934	836	689	147	17.6
1935	941	745	196	20.8

When the currency changes were made, the Minister of Finance declared that the

budget would be balanced in eighteen months. Yet preliminary figures for the year 1935-36 show a deficit larger than the previous year's, which was \$196 millions, the total of deficits since 1931 being \$776 millions. Against these totals, however, have to be set those of debt retirement, which (in millions of dollars) have been as follows: 1931, 150; 1932, 160; 1933, 100; 1934, 115; and 1935, 125, a total of 650. The position accordingly is in actuality better than it appears to be, especially in view of the internal debt consolidation effected at the beginning of 1936. This substituted five series of consolidated bonds totalling \$1,460,000,000 in place of 33 previous issues, some 70 per cent. of which matured during the years 1936-41, whereas the new series mature over a period of from twelve to twenty-four years. The result will be a reduction of debt charges by about \$85,000,000 annually. Moreover, in the terms of an agreement made on May 28, 1936, outstanding portions of the Flood Relief Loan of 1931 and the Cotton and Wheat Loans of 1933 were consolidated into a single

Obligation of U.S. \$16,608,329, payments being extended over a longer term of years.

Success of the Policy

Granted that the background of the new currency system leaves a good deal to be desired, its application has been characterized by remarkable success. One test is the exchange rate. During the twelve months following the abandonment of silver, average weekly rates for sterling have ranged from a low point of 14 9/32d. to a high point of 14 5/8d., a fluctuation of less than 11 32 d. In the case of the U.S. dollar, the highest rate was 30.07 cents and the lowest 29.32 cents, a range of only 0.75 cents. By June 30, 1936, the Currency Reserve Board had acquired \$225,000,000 of silver in addition to the amounts already held by the Central Bank, the Bank of China and the Bank of Communications. Of this amount, some 50,000,000 oz. were shipped in December, 1935, and January, 1936 (at the then prevailing world price, which was about 65 cents per ounce), to the United States, and on May 18, 1936, arrangements were made for the sale to the American Treasury of

further substantial amounts. No total of these latter shipments, as far as I am aware, has been published, but an official report acknowledges the part which they have played in enabling China to stabilize her currency. Enquiries in Landon indicate not merely that she is adequately supplied with sterling exchange, but that no pressure upon it has been experienced.

This appears to show that China's balance of payments has been rectified. It is certainly the case that her trade balance has improved. At the end of 1935 the adverse balance was \$343 millions: at the end of 1936 it was \$235 millions, exports showing an increase from \$575 millions at the end of 1935 to \$705 millions at the end of 1936. This expansion in turn show that, whilst her price level has risen, the rise has not been out of relation with world prices. The Shanghai wholesale price index number stood at the end of November last at 113 as compared with 103.3 in November, 1935. And judging from production figures, conditions in the interior show a corresponding improvement. According to

a review by the Director of the Bureau of Foreign Trade, wheat production, though below normal, was 17 per cent. better than in 1935; barley and beans show increases of eight and 10 per cent. respectively, whilst cotton production in Hopei, Shansi, Shensi, Honan, and Anhwei Provinces has been exceptionally good. These and similar facts, though appertaining more specifically to the world of commerce and industry; have nevertheless a very direct bearing upon that of currency and banking, in which note issues, deposits, interest rates, and so forth, are but the tokens of economic activity in general.

The Silver Question

The tokens—yes; but therein lay the whole rub of the currency change of November, 1935. “China is too metallicly-minded to do without silver,” said most of the old-timers. Others said much the same thing, as reference to pages 37 and 38 of Sir Arthur Salter’s Report to the National Economic Council on “China and the Depression” will show. Prior to November 3, 1935, the three leading Government banks

had in circulation notes to the value of \$417,414,917. These, the report just referred to said, were only winning their way into confidence because they were immediately convertible into a known and definite amount of silver. At the end of 1936 their total had increased to \$1,210,680,000 the position in detail being as follows:—

NOTE ISSUE

(\$000's omitted)

Bank	Note Issue	Reserves†
Central Bank	312,941	204,567
Bank of China	439,895	274,279
Bank of Com- munications	272,845	165,514
Farmers' Bank	125,000*	—
• Eight Commercial Banks	60,000	—
Total	1,210,680	—

*The Farmers' Bank's issue is limited to \$100 million in legal tender notes and \$30 million in smaller denominations.

†Silver and Foreign Securities.

As far as I am aware nothing has happened in any part of China to invalidate the statement that this increase has occurred without encountering, or creating, lack of confidence due to the inconvertibility of the notes into silver. There was for a time lack of political

confidence owing to the relations of Nanking with Canton, but with Canton included in Nanking's orbit the country's financial stability has greatly increased. A step still required to be taken is the reorganization of the Central Bank as a Central Reserve Bank. "The shares," said Sir Frederick Leith-Ross at the China Association's annual dinner on November 30, "should be disposed of to the public, as and when possible, and the board given as independent a status as possible." According to recent information Article 7 of the Bank's Charter has been revised so as to permit the subscription of 60 per cent., of its capital by private interests, and steps to give effect to this change are under discussion.

Rapid progress has also been made in the issue of a new subsidiary currency, which began on February 10, 1936. Total deliveries to the Central Bank up to the end of November last were:

	Pieces	\$
20 cents nickel	37,600,000	7,520,000
10 " "	50,660,000	5,066,000
5 " "	58,560,000	2,908,000
1 cent copper	263,720,000	2,657,200
$\frac{1}{2}$ " "	45,040,000	225,200
Total	455,580,000	18,396,400

In reference to this the Bank of China's Monthly Review (which is published in Chinese) says:—

“The fineness of China's old subsidiary currency was extremely variable. Exchange between it and legal tender differed locally and seasonally: confusion and complexity reached the uttermost extreme. The old subsidiary currency was reckoned in two kinds of coins, silver ten-cent pieces and copper. For many years it was influenced by speculation and cornering, and the rate of exchange was constantly varying. . . . On February 10 the Central Mint began the issue of new subsidiary coins in five denominations. These are being readily used by the people and the new system is firmly established.”

The same publication comments upon the (bank) interest rate, contrasting conditions at the end of 1934 and the first part of 1935, when the rate reached 60 cents per day per 1,000, with those which have obtained during the latter part of last year when it averaged \$0.08 per 1,000.

Firm Bond Market

Commenting upon the bond market, "The Review" says:

"At the time of the introduction of the currency reform, speculative activities in the bond market were very great. fluctuations in a single day were four or five times greater than those of a normal month. Such speculation was necessarily disturbing to the market and adversely affected industry and trade. A glance at the highest and lowest prices of the Consolidation Loan shows that the difference between them has been narrow. . . . The seriousness of the situation a few months ago upon the outbreak of the rebellion of the Southwest was certainly greater than at the time of the Fukien revolt. Yet sentiment in the bond market remained undisturbed, and the prices of bonds moved within narrow limits. . . . That confidence in Government Bonds is increasing daily and that public confidence in the Government has also grown is shown very clearly by these facts."

In London and other centres there has been a corresponding increase of confidence in regard to the outlook in China, especially in view of the steps taken by the Ministry of Finance to deal with defaults in respect of the 8 per cent. Vickers Notes and Marconi Bills, the Honan Railway, the Canton-Kowloon, the Tientsin-Pukow and Lung-Hai railways. The increase of the Customs revenue from \$315 million in 1935 to \$324 million last year, and of the Salt revenue from \$184 million to \$205 million have enhanced the good impression thus made. All things considered, China seems, after many years of trouble and doubt, to be really on the road to better times and to be becoming increasingly fitted to play her part in helping the world towards recovery.

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