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China Slams U.S. Over Debt

With Beijing's Choices Limited, U.S. Sees Little Change in Its Treasury Purchases

By BOB DAVIS in Washington and AARON BACK in Beijing

A sharply-worded commentary from China's state news agency highlighted rising concerns in America's biggest creditor nation over a possible default or downgrade of U.S. debt. Andrew Browne discusses.

As China criticized U.S. leaders over their debt wrangling, a U.S. official said the U.S. doesn't see any significant change in the pattern of Chinese bond purchases, reflecting the limited choices Beijing has in managing its money.

With over $1 trillion in U.S. Treasurys, China is among those that could be most immediately affected by any U.S. default or downgrading. While Chinese officials talk about diversifying the country's foreign-exchange reserve holdings of $3.2 trillion, market analysts say China's options are limited because there are few markets in the world outside the U.S. that are deep or liquid enough to handle China's massive foreign-exchange purchases.

On Thursday, China's frustration was evident in a pair of articles published by the state-run Xinhua news agency. In some of the strongest language from China's government on the issue so far, one Xinhua article castigated U.S. leaders for putting the world economy in jeopardy and called on them to show "some sense of global responsibility."

The other Xinhua article, however, acknowledged China's dependence on the U.S. "What can't be helped is that U.S. Treasury bonds are still the safest, most stable, least risky bonds, and the U.S. debt market is the only market that can absorb China's rapidly growing foreign exchange reserves," the second Xinhua article said.

Mid-level Chinese economic officials are in regular contact with officials in the U.S. Treasury, State Department and elsewhere in the U.S. government, looking for updates on the debt negotiations. But the most senior Chinese policy makers haven't yet picked up the phone to call their U.S. counterparts on the debt issue, said a person familiar with ongoing discussions.

Public criticism by top Chinese leaders could backfire in Congress because of the unpopularity of the Chinese regime, and could spook markets. Neither is in Beijing's interest. Indeed, the People's Bank of China, which manages the nation's reserves, has been restrained in its comments on the U.S. debt fight, putting out several statements that largely defend its management of the country's reserves.

"In the short term, they can't do anything," said Derek Scissors, an analyst at the Heritage Foundation, a conservative Washington D.C. think tank.

How China invests its reserves is a secret. The government releases only the total value, not the contents of its holdings, though many analysts estimate that about 70% of China's reserves are held in dollar assets. Japanese data over the last year or so have shown increased Chinese buying of government debt there, and Chinese officials have claimed to have boosted holdings of European bonds. But it's unknown how much China has invested in either place.

Monthly Treasury data on foreign holdings of U.S. financial assets isn't considered reliable even within the U.S. government. It is based on where orders are booked, rather than the location of the actual buyer and often conflict with unpublished estimates made by different U.S. agencies. Each year, the Treasury does an annual survey that tries to identify actual buyers and "finds that China holds many more U.S. assets" than the monthly numbers suggested, said a Standard Chartered report in June.

That said, Standard Chartered and others have published estimates that the Chinese may have begun reducing the percentage of new dollar-asset purchases. But the U.S. government official said the data the U.S. has reviewed doesn't suggest China has changed its purchase significantly in recent months

For China, a downgrade isn't likely to spur any immediate, significant changes in their U.S. Treasury investments, said David Mann, a currency strategist at Standard Chartered Bank in New York. "But this could be another reason to accelerate diversification beyond dollar paper assets and even more into real assets, especially elsewhere in Asia," he said.

Fed by foreign investment and trade surpluses, China's foreign exchange reserves rose by $152.8 billion in the three months to June to reach almost $3.2 trillion, the world's largest by far. And that was actually a deceleration from the previous three quarters, when reserves rose by nearly $200 billion every three months. According to U.S. Treasury data, China held $1.159 trillion of Treasury securities at the end of May, although many analysts say these estimates understate the true total.

Economically, the impact on China of a debt default or downgrading depends on how badly the U.S. economy is hurt. Chinese growth depends heavily on exports to the U.S.

But politically, the U.S. debate may already have damaged U.S. allies in Beijing. "The narrative that China has been financing the U.S. has taken hold in China," said Brookings Institution China scholar Eswar Prasad. "If the U.S. is seen as irresponsibly using that money, that won't go down well in China."

Those institutions most closely identified with U.S.-promoted policies, especially the PBOC, are likely to take the biggest hit. "The highly publicized and contentious nature of this debate is an additional nail in the coffin of Chinese perception of the United States as a stabilizing force and responsible actor in global economic affairs," said an analysis by the Center for Strategic and International Studies.

—Tom Lauricella and Jason Dean contributed to this article.

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