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China Loses Top Spot As Holder Of US Treasurys

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WASHINGTON (Dow Jones)--China slipped in December to the second-largest foreign holder of U.S. Treasurys behind Japan after holding the top spot for 15 months, raising concerns of a more permanent shift out of the dollar.

Foreigners were net buyers of long-term U.S. assets in December, though the pace slowed and a record amount of Treasury bills were dumped.

China was a major net seller of Treasurys, as its holdings fell over $34 billion to $755 billion in December, the largest monthly drop since at least 2000, when the Treasury Department began tracking the data online. Japan, a net buyer, moved into first place with $769 billion of Treasury holdings in December.

While some of China's Treasury holdings were shifted into longer-term bonds, the overall drop suggests that China is moving forward with plans to diversify out of U.S. assets. About 70% of China's $2 trillion-plus reserves stockpile is estimated to be denominated in dollars, and China is increasingly concerned about the growing U.S. debt load.

The Treasury sales also come amid rising tensions on a number of fronts between the two countries, with the Obama administration recently imposing duties on Chinese tires and other imports and talking tough on currency policy and Internet censorship.

"China is trying to send a subtle economic and political message to the U.S. through the deployment of its foreign exchange reserve holdings," said Eswar Prasad, a senior fellow at the Brookings Institution.

While the diversification process will be gradual given the few attractive alternatives to the dollar as a reserve currency, China is sending a message to back off on its tightly managed currency policy, in particular, and its internal affairs overall, said Prasad, who was previously head of the International Monetary Fund's China division.

Alan Ruskin, an RBS analyst, said net Treasury sales totaling about $45 billion since July is long enough to "hint strongly at a trend."

"This data is only going to add to second guessing of Chinese behavior and raise concerns that they are not showing much enthusiasm for U.S. dollar paper, at least while they trim down their 'excess' T-bill holdings," Ruskin said in a research note.

However, some analysts cautioned not to read too much into the volatile flow data. "There's no reason to panic," said Michael Woolfolk senior currency strategist at BNY Mellon.

Pointing to China's net purchase of $4.6 billion in longer-term Treasurys, he said that rather than unloading Treasurys, China is mostly just shifting into longer-dated bonds that offer a higher return.

China and other emerging economies built up fewer reserves in December given weak markets, which could also help explain the drop, said Win Thin, senior currency strategist at Brown Brothers Harriman.

"While the December data is a cause for modest concern that bears watching, we do not think the big global reserve managers are dumping U.S. dollar assets on a sustained basis," said Thin.

Overall, net foreign purchases of long-maturity U.S. securities totaled $50.9 billion compared to the prior month, Treasury said Tuesday.

In November, purchases totaled $114.1 billion, according to the monthly Treasury International Capital report, known as TIC.

While foreigners still bought long-maturity debt, they sold Treasury bills, at a record $53.0 billion.

Yields Tuesday on the four-week bill were 0.043%. The 10-year was trading at 3.714%.

"The unwind of the safe haven trade in US T-Bills continues," ING Bank said.

The monthly Treasury report highlights cross-border acquisitions of securities with maturities of more than one year, including non-market transactions such as stock swaps and principal repayment on asset-backed securities.

The closely watched figure excluding transactions that didn't occur on an open market recorded net buying of $63.3 billion in long-term U.S. securities, after purchases of $126.4 billion in November, the report said.

The report's most comprehensive category, "monthly net TIC flows," includes non-market flows, short-term securities and changes in banks' dollar holdings. This measure of net foreign capital inflow was $60.9 billion in December, versus an inflow of $30.7 billion the previous month.

Financial market analysts consider the monthly data from the Treasury Department to be a significant, but imprecise, gauge of how easily the U.S. can finance its trade deficit.

The government last week reported it ran a $40.18 billion trade deficit during December, up 10.4% from $36.39 billion in November. Imports grew faster than exports.

Within the long-term securities category of the TIC report, foreign net purchases of U.S. Treasury notes and bonds were $69.9 billion in December, compared with net purchases of $117.9 billion in November.

Private foreign investors bought a net $48.06 billion in Treasury notes and bonds in December, after buying $86.64 billion the previous month. Official foreign buyers, such as central banks, bought a net $21.98 billion of these Treasurys, compared with net purchases of $31.18 billion the month before.

Net foreign purchases of debt issued by U.S. government-sponsored agencies like Fannie Mae (FNM) and Freddie Mac (FRE) totaled $49.0 million in December, compared with a $5.91 billion in purchases in November.

For U.S. equities, net foreign purchases totaled $20.15 billion in December, compared with purchases of $9.66 billion the previous month.

For corporate bonds, net foreign sales were $7.94 billion, versus sales totaling $4.56 billion the previous month.

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