



washingtonpost.com

China's U.S. Debt Holdings Pass Japan

Stake Gives Beijing More Influence

By Anthony Faiola and Zachary A. Goldfarb
Washington Post Staff Writers
Wednesday, November 19, 2008; D01

China passed Japan to become the U.S. government's largest foreign creditor in September, the Treasury Department announced yesterday, reflecting the dramatic expansion of Beijing's economic influence over the American economy.

China's new status -- it now owns nearly \$1 out of every \$10 in U.S. public debt -- means Washington will be increasingly forced to rely on Beijing as it seeks to raise funds to cover the cost of a \$700 billion bailout. China, in fact, may be the government's largest creditor, period. The Treasury Department does not keep records on domestic bond holders. But analysts said China's holdings are so vast that the existence of a larger stakeholder in the United States now seems unlikely.

The growing dependence on Chinese cash is granting Beijing extraordinary sway over the U.S. economy. Analysts say a decision by China to move out of U.S. government bonds, for economic or political reasons, could lead a herd of other investors to follow suit. That would drive up the cost of U.S. borrowing, jeopardizing Washington's ability to fund, among other things, a stimulus package to jump-start the economy. If China were to stop buying or, worse, start selling U.S. debt, it would also quickly raise interest rates on a wide variety of loans in the United States, analysts say.

Additionally, the more China invests in U.S. debt, the harder it becomes for U.S. companies to sell their products overseas. That's because China's purchase of U.S. bonds makes the dollar stronger, particularly against the Chinese yuan, which has been kept artificially weak to boost Chinese exports. The relatively weak yuan remains one of the biggest obstacles to U.S. companies tapping the market in China, particularly lucrative now as Beijing embarks on \$586 billion in infrastructure and other stimulus spending to keep its economy humming amid the global crisis.

In the United States, Chinese influence is already reflected in terms as basic as home mortgage rates. Since the U.S. government seized Fannie Mae and Freddie Mac in September, China, which maintains the world's largest cash reserves of roughly \$1.9 trillion, has shed about \$50 billion in the companies' debt and mortgage bonds, according to people who track the data. With China shying away from buying more, Fannie Mae and Freddie Mac have had to pay more to borrow and have gotten less for mortgage bonds, pushing up rates for people seeking home loans just as the U.S. government is trying to bring them down.

"This is a sign of the growing interdependence between the Chinese and U.S. economies, but also a sign of a relationship that is not healthy in the long term," said Eswar Prasad, an economics professor at Cornell University and a senior fellow at the Brookings Institution in Washington. "There are inconsistent policies on both sides of the Pacific that are working against a more flexible Chinese exchange rate and the reduction of China's large trade surplus. This is a problem for the United States."

In good times, U.S. companies tapped China as a bargain-basement manufacturing hub, helping lift hundreds of millions of Chinese out of poverty. But China's torrid growth has also caused severe environmental damage from a rapid rise in pollution and industrial waste, even as it improved American lifestyles by putting cheaper televisions and microwave ovens within easier reach for consumers. In recent years, Chinese cash also became part of a massive surge in foreign capital to the United States that brought down interest rates and eased the credit terms that a range of American financial institutions charged.

Now, in bad times, China is effectively co-financing the \$1 trillion annual U.S. deficit and massive government bailout of the financial system. It is doing so in part with money earned from exports to the United States, which last year imported five times as much as it exported to China.

The surge in Chinese buying is part of a rush by panicked investors into U.S. Treasuries, an indication that lending to the U.S. government is still seen as among the safest investments in uncertain times.

"It is occurring in an environment where global investment prospects are less enticing," said Lawrence Goodman, head of emerging market strategy at Bank of America. "There is a movement for foreigners to seek safer haven investments like Treasuries versus more risk-oriented foreign investments."

China's investment in U.S. Treasury bonds surged by \$43.6 billion to \$585 billion in September, pulling ahead of the Japan, which now holds \$573.2 billion worth. Overall, analysts say China's holdings may be \$800 billion or more. China is believed to be purchasing U.S. debt through third countries, purchases that are not immediately recorded by the Treasury Department as being held by China, analysts say.

In contrast to Japan, one of the United States' closest allies, China is seen as less benevolent to U.S. interests.

Many economists are concerned about U.S. reliance on China for funding. By buying Treasury bonds, which are denominated in dollars, China is able to keep the dollar strong compared with the yuan. As a result, Chinese exports are cheaper relative to U.S. exports.

That is a friction point at a time when the U.S. needs manufacturing companies to be competitive in the global marketplace to combat the economic downturn. U.S. labor unions are already pushing the incoming Obama administration to urge the Chinese to take steps to strengthen the yuan, which could involve a broad sell-off by China of U.S. Treasury bonds.

"This is an unhealthy relationship," said Brad W. Setser, geoeconomics fellow at the Council on Foreign Relations. "The U.S. relies too heavily on subsidized financing from a non-democratic government. And China is still a poor country that has in turn invested too much of its national savings in the United States. There remains an underlying financial vulnerability if China were to scale back its purchases. It could deliver a shock to the United States."

Post a Comment

[View all comments](#) that have been posted about this article.

You must be logged in to leave a comment. [Login](#) | [Register](#)

Submit

; or material will be removed from the site. Additionally, entries that are unsigned or contain "signatures" by someone other than the actual author will be removed. Finally, we will take steps to block users who violate any of our posting standards, terms of use or privacy policies or any other policies governing this site. Please review the [full rules](#) governing commentaries and discussions. You are fully responsible for the content that you post.