China to dump billions of dollars of US Treasury Bills

By Global Research
Global Research, March 10, 2007
Associated Press 10 March 2007

Region: Asia
Theme: Global Economy

China to create firm to invest its $1 trillion in reserves

By Joe McDonald – ASSOCIATED PRESS

BEIJING — China will soon create one of the world's largest investment funds, with ramifications for global stock, bond and commodities markets and for how the U.S. finances its trade deficits.

Finance Minister Jin Renqing said on Friday the aim is to make more profitable use of its $1 trillion in foreign currency reserves that have piled up as it posted huge trade surpluses year after year. Most of those funds are now parked in safe, but relatively low-yielding U.S. Treasury securities and other dollar-denominated assets.

"We can achieve more profit from the investments," Jin said at a news conference. "We are now preparing the organization of this new corporation."

Jin said Beijing may follow the lead of Singapore's Temasek Holdings, which manages nearly $90 billion in government pension funds and other assets. It owns stakes in Singapore Airlines and Singapore Telecom, as well as in banks, real estate, shipping, energy and other industries in India, China, South Korea and elsewhere.

Analysts have speculated for some time that China would create an investment company, and officials have said repeatedly they want to make better use of the country's reserves.

Economists have suggested Beijing might allocate as much as $200 billion to $400 billion to the new company, which in a single move could create one of the world's richest investment funds.

"They want to be more aggressive than what they do with current reserves," said economist Mingchun Sun at Lehman Brothers in Hong Kong. "They could invest in higheryield products — stocks, corporate bonds, maybe even commodities," Sun said. "Basically, the returns would be higher because the risk is higher."

A shift in China's investment strategy could change its purchases of Treasuries, affecting a market that Washington relies on to help finance multibillion-dollar budget deficits, and perhaps eventually push up U.S. interest rates.

But Lehman Brothers' Sun played down that risk. He said that with its reserves growing by as much as $20 billion a month, Beijing could afford to keep buying U.S. government bonds while also channeling billions into new investments.

Even so, news of the Chinese announcement — along with an upbeat jobs report, which reduced expectations the Federal Reserve will need to cut U.S. interest rates — came on the same day of a big drop in the price of the benchmark 10-year Treasury note Friday. That pushed up its yield to 4.58 percent from 4.51 percent late Thursday.

The Commerce Department also reported on Friday that the U.S. trade deficit with China soared 12 percent to $21.3 billion, even as the overall gap between what America sells abroad and what it imports slimmed slightly in January to $59.1 billion from a December deficit of $61.5 billion.

Jin gave no details of how the Cabinet-level company might invest the reserves, nor did he say what portion of the reserves might be channeled through the company or when it would start to operate.

U.S. Treasury Secretary Henry Paulson, in an interview this week on the U.S. television network ABC, rejected suggestions that changes in Chinese bond purchases could affect the United States. Paulson said Beijing's entire holdings represent the equivalent of less than a single day's trading in Treasuries on global bond markets.

Chinese economists and media reports have suggested China might adopt more unusual investment approaches, ranging from stockpiling oil and other raw materials to spending more on social programs in order to encourage Chinese consumers to spend more and reduce dependence on exports.

The growth in China's reserves is driven by the rapid growth of its exports, which brings in dollars, euros and other foreign currency, and by the billions of investment dollars being poured into the country.

The surge in money flooding in from abroad forces the central bank to drain billions of dollars from the economy every month by selling bonds in order to reduce inflationary pressures.

The precise composition of China's foreign currency reserves is a secret. But economists believe that as much as 75 percent is believed to be in U.S. dollar-denominated instruments, mostly Treasuries, with the rest in euros and a small amount in yen.

Stephen Green, chief economist at Standard Chartered Bank in Shanghai, calculated that last year the central bank made a $29 billion profit on its Treasury holdings after paying interest on its own bonds and other expenses.

But even that represents a return of less than 3 percent on the $1 trillion in holdings.

By contrast, Singapore's Temasek says it has averaged an 18 percent annual return since it was created in 1974.

Become a Member of Global Research

Articles by: Global Research