Focus: Fears Grow over China's Possible Massive Sales of U.S. Debt as Weapon

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Global Research, September 04, 2020
Kyodo News 20 August 2020

Region: Asia, USA
Theme: Global Economy

With Sino-U.S. tensions escalating over several security and economic issues, fears are mounting in the financial markets that China may massively sell U.S. government debt it holds as a weapon to choke the world's biggest economy.

If Beijing, which owns more than $1 trillion worth of U.S. Treasury bonds, really takes such action, that would push down debt prices and drive up interest rates in the United States, stifling investment and consumer spending at home.

As large-scale sales of U.S. dollar-denominated assets would trigger the depreciation of the currency against the Japanese yen, the Asian nation's economy could be also beset by a downturn in exports, a key engine of growth, diplomatic sources said.

> "Should China sell U.S. bonds at a rapid pace in a bid to attack the United States, relations between the two countries would irrecoverably deteriorate," said Yuzo Sakai, chief manager of foreign exchange business promotion at Ueda Totan Forex Ltd.
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> "Under such circumstances, market participants would rush to buy the safe-haven Japanese currency by selling risky assets, probably leading to a steep appreciation of the yen," Sakai said.

Recently, the United States has been intensifying its offensive against China, especially after the mainland enforced a controversial national security law for its territory Hong Kong, which has been lambasted for eroding freedoms and human rights there.

In late June, China enacted the legislation to crack down on what it regards as secession, subversion, terrorism and collusion with foreign forces in Hong Kong, apparently aiming to quell anti-government protests in the former British colony.

Since then, the administration of U.S. President Donald Trump has taken steps such as ordering China to shut down its consulate general in Houston, Texas, and imposing sanctions on Chinese officials including pro-Beijing Hong Kong leader Carrie Lam.

China has so far implemented retaliatory measures against the United States, sparking concern that their battle would develop into a "financial war," one of the diplomatic sources said.

Amid speculation that Trump may ultimately expel China from the dollar settlement system in the world, the leadership of President Xi Jinping could “threaten the United States by saying it will sell U.S. Treasury debt at high volume,” the source said.

Indeed, China has been gradually letting go of U.S. bonds since Trump waged a tit-for-tat tariff trade war in 2018.

In June, China decreased its holdings of U.S. Treasury bills, bonds and notes by $9.3 billion to a total of $1.07 trillion, according to the U.S. government. China has already fallen behind Japan to become the second-biggest holder of U.S. Treasury debt.

Bond prices move inversely to yields. If a U.S. Treasury sell-off accelerates, it could bring a surge in interest rates, dealing a crushing blow to the U.S. economy with mortgage rates and corporate borrowing costs ballooning, analysts said.

Should the outlook for the U.S. economy dim and risk-averse sentiment spread in the financial market, demand for the yen would grow, which could impede recovery in Japan’s export-oriented economy, they added.

A higher yen usually dampens exports by making Japanese products more expensive abroad and cutting the value of overseas revenues in yen terms.

> “The Japanese economy has languished due in part to the new coronavirus pandemic and last year’s 2-percentage-point consumption tax hike. In addition to them, if the yen excessively rises, Japan would face a predicament,” another diplomatic source said.

Japan’s economy in the April-June period shrank an annualized real 27.8 percent from the previous quarter, the sharpest contraction on record.

Some pundits, however, have ruled out the possibility of China’s massive selling of U.S. debt, saying it could backfire on Beijing.

A U.S. Treasury sell-off “might damage the United States in the short term but it would inculcate critical economic instability into the global and Chinese economy,” said Stephen Nagy, a senior associate professor at International Christian University in Tokyo.

Jeff Kingston, director of Asian Studies at Temple University Japan in Tokyo, echoed the view, saying the question is “where would all that liquidity be invested and how disruptive might that be?”

> “Nudging a fragile global economy into the abyss has great potential to harm China’s economy,” he said.

Kingston added that dumping U.S. Treasury bonds “would lower the price as they are sold off, and other countries might see them as relatively attractive compared to other investment options and scoop them up at bargain prices.”

But an institutional investor at a major security house in Tokyo said it may be difficult for Japan to boost its holdings of U.S. government debt as the move could be condemned by other nations as a “currency manipulation.”

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