China & US Treasuries

- US Treasury data indicate China reducing exposure to Treasuries since end 2013
- Pace of reduction increased since June 2018
- Reduction over past 10 months comes despite no major shift in USD value of FX reserves

The latest US Treasury Department report detailing shifts in foreign holdings of US Treasuries once again made for interesting reading given the continued focus on the relationship between the US and China.

While the USD 7.5bn reduction in China’s holdings reported in May failed to elicit much response from the market, it’s still worth providing some context around this number.

Beijing began expressing concerns about its exposure to the US over a decade ago. However, these concerns came rather more to the fore in August 2011, at the time of the S&P downgrade of US sovereign debt.

It’s arguable that this provided the spark for an active debate within China over the next two years about currency policy. Much of this came to a head around the time of the third Plenum in November 2013.

“IT’S NO LONGER IN CHINA’S”

Newswatch

1. **US:** President Donald Trump says (when asked if he still wants to demote Federal Reserve Chairman Jerome Powel): “Let’s see what he does.”

2. **China:** The PBOC announces it will sell CNY 30 bn of CNY-
Perhaps the most pertinent outcome of this debate was an announcement at the time of the third Plenum by then PBOC deputy governor Yi Gang that “it’s no longer in China’s favor to accumulate foreign-exchange reserves”.

Consistent with this, November 2013 also proved the high water mark for China’s holdings of Treasuries. Since then, China has reduced its exposure to the US Treasury market by USD 203.7bn or 15.4%. That’s an average decline of USD 3.3bn a month.

The pace of these declines has varied over time, however. Putting aside the anomaly that emerges between June 2016 and August 2017 (when some speculation emerged over whether China’s holdings were showing up elsewhere in the data) the most notable shift has come since June of last year.

Up until this point the average pace of monthly declines was running at USD 2.28bn. However, since June of last year and the commencement of the US/China trade tensions, the average monthly drop has been USD 7.8bn. April’s move was therefore in line with this.

Interestingly this was also just a little above the average monthly decline seen in Russia’s holdings in 2018 (USD 7.4bn) when it was looking to reduce its exposure to the US.

Since trade tensions emerged between the US and China there has been a notable pick up in the rate of reduction

Does this tell us anything?

The Treasury data make two things relatively clear. Firstly, China has been reducing its exposure to US Treasuries since the third plenum in 2013 (see chart below).

This, in turn, has been consistent with what was said at the time. However, since trade tensions emerged between the US and China there has been a notable pick up in the rate...
of reduction.

It’s also interesting to note that this has come without a particularly major shift in the overall valuation in USDs of China’s FX reserves (off just USD 17bn).

With this in mind, the key question for next month will be whether May (the month the trade talks broke down) saw a pick up in the pace of portfolio reduction from USD 7.8bn.

If so, then that might catch the attention of FX reserve managers elsewhere.

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