

China's economic 'bargaining chip'

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Four years ago, when the foreign-exchange reserves of China totaled about \$450 billion and the value of China's holdings of U.S. securities was about \$300 billion, former Treasury Secretary Lawrence Summers warned about the emergence of a global "balance of financial terror."

Mr. Summers and others worry that U.S. consumption and investment levels are becoming dependent on "the discretionary acts" of other governments. Foreign governments and investors are accumulating huge pools of dollars by virtue of the massive trade deficits the United States has been running. What these governments decide to do with their rapidly growing dollar reserves could have a huge effect on the U.S. economy.

"There is surely something odd about the world's greatest power being the world's greatest debtor," Mr. Summers told the audience gathered at the Peterson Institute for International Economics in Washington.

"It surely cannot be prudent for us as a country to rely on a kind of balance of financial terror" that exists today, he said.

Since Mr. Summers' March 2004 speech, the United States has racked up an additional \$1.2 trillion in budget deficits and about \$3 trillion in trade deficits, including more than \$900 billion in merchandise trade deficits with China alone.

China's currency reserves have kept growing since 2004, in tandem with its ever-expanding trade surpluses and foreign direct investment, which has built many of China's export-generating factories. So-called "hot money" has also been pouring into China seeking to reap the gains from its slowly appreciating currency.

Not surprisingly, China's foreign-exchange reserves have soared, quadrupling from \$450 billion in early 2004 to more than \$1.8 trillion today. The International Monetary Fund expects China's currency reserves will exceed \$2.4 trillion by next year.

China's holdings of U.S. securities have increased from \$300 billion in March 2004 to more than \$900 billion in June 2007, the latest date for which data are available. Given America's \$250 billion trade deficit with China over the past year and the steady stream of money pouring into the country from abroad, economists believe China probably holds nearly \$1.2 trillion in U.S. securities today, mostly Treasuries and corporate bonds.

And that doesn't include the roughly \$140 billion in U.S. securities held by Hong Kong.

China syndrome

Source: David M. Dickson