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Opinion

China rattles US Treasury market - but why?

Newswires are full of talk of China's intention to buy fewer Treasuries, but what is the purpose of this announcement?

The headline story on most business newswires today is that China has suggested that it will buy fewer US Treasuries in future. Most of the stories concern the impact on the US Treasury market, which briefly sold off, with yields on benchmark long dated bonds coming close to 2.60% (up about 5 basis points) before a very strong auction, and rumours that the US favoured pulling out of NAFTA brought yields back in line with their open (in currency markets, the Canadian Dollar and Mexican Peso were hit hard as a result).

1.2

\$trillion China holdings of US treasuries
Single biggest foreign holder of US Treasuries

But incremental purchasing small relative to size of market

Other stories seek to calm nerves by noting that although the single largest foreign holder of US Treasuries (about \$1.2tr as of October 2017, a little ahead of Japan at \$1.1tr), the incremental buying of Treasuries by China is small relative to the size of the market (fair point) and is also much less than it was, now that the current account surplus is only about 1% of GDP, than a decade or so ago when it was nearing double digits. Again, all fair points. Others note that to cause a bear market in Treasuries is not therefore in the interests of China – also fair. But in that case, unless this is simply a bad PR mistake, why make the comment about tapering Treasury purchases?

A pre-emptive strike to ward off trade tariffs?

The most likely explanation, aside from a mistake, in this author's opinion, is to demonstrate that China is unlikely to passively accept tariffs on steel, aluminium, and solar panels - industries the US Trade authorities are looking to penalise shortly for unfair trade practices. It's a case of "you hurt us, we'll hurt you, even if it also hurts us". With the US Fed slowing its repurchase of maturing Treasury assets, US Treasuries are perhaps more vulnerable to such threats by China than they might have been when the Fed was hard at work soaking up the available supply. This is no hollow threat. It now remains to be seen what the US does with respect to trade sanctions...

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