

Are we at risk of a Chinese dollar dump?

[Robert J. Samuelson](#)



At last count, China held slightly [more than \\$1 trillion](#) in U.S. Treasury securities. One fear has been that, should China and the United States engage in an economic war — as they clearly are now — those dollars could become a weapon against us. The Chinese would sell dollars in foreign exchange markets, raising U.S. interest rates and perhaps triggering a serious American recession that might spread elsewhere.

Is this possible? Well, yes. But it's a long shot. Let's see how a dollar dump

might work.

China would sell a huge portion of its Treasury stake. This, in turn, would reduce the price of Treasuries — which, like stocks, are traded on the open market — and raise their interest rates. Consider a simplified example to see how this works. Assume a \$1,000 bond with a 5 percent interest rate. It guarantees a payment of \$50 a year. But if the bond's price has fallen to \$800, that same promised \$50 produces an interest rate of 6.25 percent.

Higher interest rates would then percolate through the U.S. economy, affecting consumer and business spending. If the reaction were powerful, a recession might result. Spending would weaken, unemployment would rise, and confidence would fall.

China's dumping of Treasuries would escalate the economic conflict between the two countries. It would signal a second fundamental break with the post-World War II global economic system, with the first being President Trump's aggressive use of tariffs.

But two practical caveats arise.

First, the Chinese might be victims of their own policies. A global recession would reduce exports, compounding the effect of the 25 percent U.S. tariffs on \$200 billion of Chinese exports. The dollar's exchange rate might fall, while China's renminbi might rise. The shift in exchange rates would weaken China's competitive position. China's sale of some U.S. Treasuries would also reduce the value of the Treasuries that aren't sold.

Why would the Chinese inflict these costs on themselves? Good question. Selling Treasuries "is perhaps the least potent weapon in its arsenal of potential retaliatory strikes against U.S. trade sanctions," says economist Eswar S. Prasad of Cornell University. He doubts that China will do it.

The second caveat is the opposite of the first. It is that China might sell lots of Treasuries, and very little would happen. Interest rates would hardly budge. Already, China's current account surplus — a [broad measure](#) of trade — has been shrinking, and this implies that China is accumulating fewer dollars than before. But that hasn't sent interest rates soaring. They remain historically low. The rate on 10-year Treasuries is [less than](#) 2.5 percent.

One explanation is that the world seems to have a huge appetite for U.S. Treasury securities, which are called "[safe assets](#)" by financial experts. This means that, despite all of the United States' economic and political problems, investors don't believe the United States would default on its government debt. Treasuries are a good place to leave idle funds.

The various possible consequences have led many observers to doubt that China would deliberately try to undermine the U.S. Treasury market. This is how Capital Economics, a forecasting firm, judged the prospects:

It "wouldn't be sensible. If such a fire sale [of Treasury securities] drove up their yields [interest rates], China would lose money on its remaining holdings. It might also lead to greater instability in emerging financial markets. This includes China, which the authorities there want to avoid."

[David Smick](#), editor of the International Economy magazine, echoes this appraisal. Dumping Treasuries poses too many risks, including a global recession. "It's a declaration of war — not just against the United States, but the world," he says. "I don't think the Chinese are going to do that."

Whatever happens, the China story is undergoing significant revision. Not so long ago, its economy [was growing](#) at a rate of 10 percent a year. Now that's slipped to [about 6 percent](#), and many economists expect it to decline further. [Derek Scissors](#) of the American Enterprise Institute thinks it could drop to 4.5 percent this year, and as low as 1 percent to 2 percent within a decade.

There are many obstacles to faster growth. Debt is one. Although it spurred growth in the past, borrowing in China has now reached levels that look increasingly unsustainable. From 2005 to 2018, loans to Chinese nonfinancial corporations went from 112 percent of gross domestic product to 152 percent of GDP, reports the Institute of International Finance, an industry research and advocacy group.

The resolution of this struggle is unclear. But, if nothing else, the collision between the Trump administration and Beijing heralds a new era in U.S.-China relations. Both countries are caught in contradiction, being in conflict and dependent on each other at the same time.

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