Chinese leader Wen's remarks put focus on U.S. Treasuries

By David J. Lynch, USA TODAY

Investors this week may be watching the U.S. Treasury market a bit more closely than usual.

Any heightened scrutiny would be thanks to Chinese Premier Wen Jiabao, who said Friday he was "a little bit worried" about the safety of his government's U.S. investments.

"We lent such huge funds to the United States, and of course we're concerned about the security of our assets," Wen said at a press conference following the annual session of the country's rubber-stamp legislature.

With the already heavily indebted United States headed for massive additional borrowing to finance its economic recovery, the Chinese are worried their U.S. holdings could take a beating. State-owned sovereign wealth funds lost heavily after taking high-profile stakes in U.S. financial institutions, including the private equity firm Blackstone Group.

"I view it as a not-so-subtle reminder to the U.S. that the U.S. needs China as much as China needs the U.S.," said Eswar Prasad, former head of the International Monetary Fund's China division.

For now, a general flight from Treasuries is unlikely. Despite Wen's grumbling, the Chinese in recent months have been adding to their Treasury stockpile. Amid the global crisis, China wants safe investments in large, liquid markets, Wen said. That leaves China with few alternatives to a continued embrace of Treasuries. As of December, the most recent figures available, China held $727.4 billion in Treasuries, about $200 billion more than in June.

Market reaction Friday to Wen's comments was modest. The yield on the 10-year Treasury bond inched up to 2.90% vs. 2.86% one day earlier.

China's chronic trade surplus translates into enormous amounts of dollar reserves that must be invested somewhere. At year's end, China was sitting on an extraordinary $1.95 trillion in reserves, the world's largest financial war chest.

China added to its Treasury holdings in the fourth quarter by abandoning an effort to diversify its reserves, says Brad Setser, a former Treasury Department economist. As the global financial crisis intensified late last year, China moved money out of riskier assets it had ventured into, such as corporate debt and Fannie Mae and Freddie Mac bonds.

"China bought increased sums of Treasuries and put a far larger fraction of its reserves into Treasuries than before," says Setser, now with the Council on Foreign Relations.

This year, China's trade surplus is expected to be smaller, so it will likely purchase fewer Treasury securities. Still, while China remains the largest foreign Treasury buyer, U.S. investors buy more than half the annual total Treasury issuance.