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China Worried About U.S. Debt

Biggest Creditor Nation Demands A Guarantee

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Exerting its new influence as the U.S. government's largest creditor, China yesterday demanded that the Obama administration "guarantee the safety" of its $1 trillion in American bonds as Washington goes further into debt to combat the economic crisis.

Chinese Premier Wen Jinbao made the demand at the end of the National People's Congress in Beijing at a time when relations between the two nations show fresh signs of strain.

"We have lent a huge amount of money to the U.S. Of course we are concerned about the safety of our assets," Wen said. "To be honest, I am definitely a little worried."

China surpassed Japan last year as the largest foreign holder of Treasury bonds. Any indication that it intends to cease those purchases -- or, worse, stage a sell-off -- could drive up the cost of borrowing for the U.S. government, as well as send mortgage rates higher for millions of Americans.

That reality, experts say, has given China more leverage in its dealings with Washington, with some seeing Wen's comments yesterday as amounting to economic saber-rattling. The words came only days after a confrontation in international waters between a U.S. military ship and five Chinese vessels that sparked recriminations on both sides of the Pacific. Chinese officials have also signaled alarm over a growing "protectionist" sentiment in the U.S. Congress that could further endanger its exports, now in sharp decline as world demand spirals during the global economic crisis.

Those circumstances illustrate the pitfalls the Obama administration is facing as it charts its relationship with China. In January, for instance, the administration signaled that it would confront Beijing on the manipulation of its currency, the yuan, which has been kept artificially low against the U.S. dollar, making Chinese products cheaper around the world. Critics call that one of the major factors behind the U.S. trade deficit.

"The power that China now has is that its actions are seen as a leading indicator of the confidence that foreign investors will have in the ability of the U.S. government to pay the debt," said Eswar Prasad, senior fellow at the Brookings Institution. "These comments are saber-rattling in the sense that they are using that leverage to tell the U.S. to back off on currency policy and trade policy."

A number of Chinese officials have expressed concern about the future of Beijing's holdings of U.S. debt. American officials have sought to ease those concerns, effectively acknowledging the importance of China's role as Washington's banker. Last month, Secretary of State Hillary Rodham Clinton urged the Chinese to keep buying U.S. bonds. Asked about the increasingly jittery reaction in China to the rising U.S. debt, White House economic adviser Lawrence H. Summers yesterday defended the expensive policies that are forcing the nation to borrow a record $2.5 trillion this year, by White House estimates.

"In the short run, the need is to get the economy going again," Summers told a packed auditorium at the Brookings Institution, a Washington think tank. Summers acknowledged that fiscal stimulus and various financial-sector bailouts are forcing the nation to borrow massive sums, but the alternative, he said, would be much worse. "If deflation sets in, if the GDP collapses further . . . if that happens, the magnitude of the federal borrowing, as large as it is today, will be dwarfed. It will be far, far larger."

But concern is rising about the value of U.S. bonds. Though they remain the choice for investors seeking a safe haven in hard economic times, analysts are already murmuring about a possible downgrade on the rating of U.S. Treasurys in the future. The talk comes as Washington is issuing more debt and printing more dollars to stimulate the economy -- something that could bring down the value of the dollar in the months to come. That, in turn, would dilute the value of the U.S. dollar-denominated bonds held by the Chinese and other investors. Wen called on the United States to "maintain its good credit, to honor its promises and to guarantee the safety of China's assets."

Wen, however, stopped far short of saying China would cease purchasing Treasurys. Although analysts say China may already be moving to curb some purchases of U.S. debt, any move to sell off its current holdings would severely deflate their value on world markets -- hurting the Chinese as well as the Americans. Years of red-hot growth have allowed China to build up the world's largest reserves -- some $2 trillion. But analysts say almost half are held in U.S.-government-backed debt.

The White House sought to reassure global investors about the safety of U.S. Treasury securities. "There is no safer investment in the world than in the United States," White House spokesman Robert Gibbs said.

Longer-term Treasurys weakened slightly in trading after Wen's comments about soaring U.S. debt.

Additionally, it is not in China's interest to enter into economic confrontation with its largest client -- the United States -- particularly as its exports are in free fall worldwide. Though the Department of Commerce yesterday said the U.S. trade deficit narrowed 9.7 percent in January to its smallest level since October 2002, the deficit with China alone actually increased slightly, to $20.57 billion.

"I think what they're trying to say right now is, 'Don't take any steps that would impair our ability to access your market,' " said Auggie Tantillo, executive director of the American Manufacturing Trade Action Coalition, an organization of U.S. businesses critical of China's trade policies. "The Chinese are starting to flex their muscles, they are becoming more powerful commercially and economically, and they want us to know it."

Staff writers Lori Montgomery in Washington and Ariana Eunjung Cha in Shanghai contributed to this report.