

**CHINA CURRENCY COALITION**  
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White Paper

U.S. Indebtedness to China and Japan Should Spur, Not Delay or Deter,  
Efforts to Offset Trade Imbalances Aggravated  
By Exchange-Rate Misalignment of the Undervalued Yuan and Yen  
(April 20, 2007)

Concerns have been expressed by some that the United States is so indebted to China and Japan that it would be unwise of the United States to enforce existing trade agreements by treating these and other countries' undervaluation of their currencies as a countervailable prohibited export subsidy. Underlying this view is the thought that such corrective measures might lead China and Japan to respond in a retaliatory fashion by liquidating their U.S. debt securities and diversifying large amounts of their dollar holdings into other investments elsewhere. The fear is that the result of this action would cause a dangerous run on the dollar, dramatically raise U.S. interest rates to the serious detriment of the U.S. economy, and perhaps create a global financial crisis.

These anxieties are not borne out by the facts and practicalities. It is true that U.S. indebtedness to foreign lenders is large, and the trend-lines are troubling and indicative that U.S. indebtedness likely will continue to increase unless remedial steps are taken. China and Japan, however, finance a relatively small portion of overall U.S. foreign-held debt and a much smaller portion of U.S. credit market debt. Moreover, the dollar has a broad, deep, and competitive market based upon confidence in the United States and its economy. As Secretary Paulson observed in a hearing before the Senate Banking Committee on January 31, 2007, the dollar provides the best risk-adjusted return available for investors' money. China and Japan, as significant holders of U.S. debt, presumably concur in this assessment and do not want to act in a way that would cause the dollar to weaken and the value of their investments in U.S. dollars to decrease. Under these circumstances, it is reasonable to conclude that the United States is not beholden to China and Japan for financing U.S. debt. Even if China and Japan were to shift some portion of their investments from the dollar to other currencies, it could be expected that other lenders would take their place.

With more particular regard to the value of holdings in U.S. securities by China, Japan, and other foreign countries, attached are three tables derived from recent reports by the U.S. Treasury Department and the U.S. Federal Reserve: Table 1A contains data as of June 2005 and June 2006 on the composition of foreign holdings of U.S. debt securities by the largest 25 lending countries and overall; Table 1B shows U.S. credit market debt for all sectors and by instrument as of June 2005 and June 2006; and Table 2 provides data on the 25 countries that are the largest foreign holders of U.S. credit and their shares of total market debt as of June 2006. A number of points from these reports are worth highlighting.

First, as noted in Table 1A, China held approximately \$298 billion and Japan held approximately \$666 billion, for a total of \$964 billion, of U.S. Treasury short- and long-term securities as of June 2005. The preliminary data from June 2006 show China's number growing to \$372 billion and Japan's number falling to \$614 billion, for a total of \$986 billion. China and Japan together have accounted over the last two years for about half of the roughly \$2 trillion in foreign-held U.S. Treasuries.

But foreign-held U.S. Treasuries are less than half of total U.S. Treasury debt. As shown in Table 1B, from June 2005 to June 2006, the total of U.S. Treasury securities outstanding grew from \$4.49 trillion to \$4.76 trillion. China's and Japan's cumulative share of U.S. Treasuries thus increased from 20.3 percent as of June 2005 to 20.7 percent as of June 2006.

As summarized in Table 1A, in June 2005 China held \$527 billion and Japan held \$1,091 billion in U.S. credit market debt, which includes U.S. Treasuries, U.S. government agencies' debt, municipal debt, corporate and other privately-issued debt, and equities. As of June 2006, the comparable figures were \$699 billion for China and \$1,106 billion for Japan.

When compared, therefore, with total U.S. credit market debt outstanding, which Table 1B records grew from \$39.2 trillion in June 2005 to \$42.7 trillion in June 2006, China's share was 1.3 percent as of June 2005 and 1.6 percent as of June 2006. Japan's share of total U.S. credit market debt outstanding was 2.8 percent as of June 2005 and 2.6 percent as of June 2006. Thus, in the very large total U.S. credit market, Japan and China held about 4.1 percent of outstanding credit as of mid-2005 and about 4.2 percent of outstanding credit as of mid-2006, and only a fraction of this debt has been held by their governments.

As reported in Tables 1A, 1B, and 2, from June 2005 to June 2006, credit held by foreigners increased \$915 billion, from \$6.86 trillion to \$7.78 trillion. China and Japan accounted for \$187 billion, or 20 percent of this increase, while 109 other entities also increased their holdings of U.S. debt, and 35 entities divested part of their holdings.

On February 28th, appearing before the House Budget Committee, Federal Reserve Chairman Ben Bernanke was asked to comment on what might happen to the market for U.S. debt securities if a foreign buyer like China or Japan were to sell off a significant portion of its holdings. Chairman Bernanke responded:

It's not in the interest of China or Japan to dump treasuries on the market. They would themselves -- would suffer capital losses from doing that. I do think if there were -- and I should be very clear, I have no information or expectation this is going to happen, but if there were significant sales by foreign central banks, for example, that there would be some short-run effect on the market in terms of the currency and interest rates, probably. I think the

longer-term effect would be somewhat less because the market would adjust -- it is a liquid market and the holdings of, say, China of U.S. debt securities, including both public and non-public, is only about 5 percent of the total credit market outstanding. So obviously we're watching that very carefully. I don't see that as a major threat to our financial system or our economy.

Chairman Bernanke's evaluation echoes that of Secretary Paulson and is substantiated by the data just reviewed. Japan and China, individually and collectively, are important purchasers of U.S. debt, but as matters stand now are not in a position to trigger the sort of financial disruptions noted earlier by selling off their holdings. In the first place, as seen, those holdings are not that great in comparison with the total U.S. credit market debt outstanding, and the market would be able to adjust due to its liquidity.

In addition, as suggested by Chairman Bernanke, a reduction by China and Japan of the amount of their holdings of U.S. debt would entail capital losses for them. This factor was underscored recently in a report by the Associated Press that Stephen Green, Chief Economist at Standard Chartered Bank in Shanghai, calculated that China's central bank made a net profit of \$29 billion on its reserve holdings. Japan also likely has realized sizable profits on its U.S. debt holdings. In the final analysis, Japan and China have too much at stake to jeopardize their trading relationships with the United States.

At the same time, if Congress does not take action to remedy the impact of exchange-rate misalignment on U.S. producers, the stability and strength of the U.S. economy will be eroded further and probably more quickly than has been the case to date. The trade and financial imbalances generated by protracted undervaluation of currencies will almost certainly be so extensive and devastating as to be extremely damaging to the national economy and security not only of the United States, but also of the countries that indulge in the undervaluation and of the global community.

In summary, the risk is rather slight at this juncture of financial turmoil resulting for the United States or any other country from a statutory declaration that undervalued exchange-rate misalignment is a countervailable prohibited export subsidy. Doing so now actually should help to avoid severe economic fluctuations and debilitation. The real risk will be run down the road if amendment of the U.S. countervailing duty law is delayed. Calling a halt to tolerance of the protectionist policy of undervalued exchange-rate misalignment is very much necessary.

TABLE 1A -- FOREIGN HOLDINGS OF U.S. DEBT SECURITIES BY TOP 25 LENDING COUNTRIES, JUNE 2005 AND JUNE 2006

No.	Country	Foreign holdings of debt securities by country as of preliminary June 2006 (top 25)						Foreign holdings of debt securities by country as of June 2005					
		(\$Millions)						(\$Millions)					
		Total	Equity Holdings	Short-Term & Long-Term Debt	U.S. Treasury Short- & Long-Term	Gov't Agency Short- and Long-Term	Corporate Short- and Long-Term	Total	Equity Holdings	Short-Term & Long-Term Debt	U.S. Treasury Short- & Long-Term	Gov't Agency Short- and Long-Term	Corporate Short- and Long-Term
1	JAPAN	1,106,396	194,542	911,855	613,915	188,519	109,421	1,091,430	177,674	913,757	666,440	142,469	104,847
2	CHINA, MAINLAND	698,929	3,818	695,111	372,234	263,878	58,999	527,275	2,542	524,733	297,811	190,347	36,575
3	UNITED KINGDOM	639,587	299,700	339,887	51,779	29,679	258,429	559,838	260,364	299,474	50,443	25,257	223,774
4	LUXEMBOURG	549,016	193,061	355,955	58,833	42,002	255,120	460,212	150,639	309,573	38,760	43,481	227,331
5	CAYMAN ISLANDS	485,044	178,083	306,961	24,513	45,255	237,193	429,983	152,204	277,779	37,208	50,361	190,211
6	CANADA	381,891	273,815	108,077	21,973	4,334	81,770	307,872	220,504	87,368	19,598	5,256	62,514
7	BELGIUM	330,776	21,415	309,361	13,710	43,763	251,888	334,886	18,062	316,824	15,619	51,244	249,962
8	NETHERLANDS	280,415	158,359	122,056	19,326	19,706	83,024	262,246	160,875	101,370	19,586	19,461	62,324
9	SWITZERLAND	261,939	144,511	117,427	39,171	10,250	68,006	238,236	129,159	109,077	36,373	10,693	62,011
10	MIDDLE EAST OIL-EXPORTERS	242,800	110,588	132,211	94,683	19,383	18,146	160,916	82,472	78,444	54,639	14,082	9,722
11	IRELAND	231,978	68,550	163,428	13,690	28,088	121,650	191,392	57,730	133,662	22,237	16,610	94,814
12	COUNTRY UNKNOWN	213,663	170	213,493	17	20	213,456	196,135	1,979	194,155	163	447	193,545
13	GERMANY	211,169	72,804	138,365	41,758	16,069	80,538	200,034	82,783	117,251	46,081	15,277	55,893
14	BERMUDA	205,610	60,033	145,577	28,749	30,885	85,943	201,895	59,054	142,841	27,991	30,476	84,374
15	FRANCE	164,216	95,324	68,892	25,888	6,287	36,717	122,138	71,331	50,807	24,776	2,455	23,576
16	SINGAPORE	162,766	100,662	62,104	35,174	6,854	20,077	144,165	88,715	55,450	34,258	6,380	14,812
17	TAIWAN	135,210	7,317	127,893	63,394	53,022	11,477	126,008	6,688	119,320	67,770	41,106	10,444
18	KOREA, SOUTH	124,213	1,323	122,890	65,578	45,924	11,388	118,257	1,132	117,125	62,933	45,075	9,117
19	RUSSIA	110,850	237	110,612	4,533	106,058	22	76,382	227	76,155	1,297	74,835	23
20	HONG KONG	110,113	22,098	88,015	48,604	26,538	12,873	95,925	23,347	72,577	44,336	20,340	7,901
21	AUSTRALIA	109,171	64,497	44,674	5,681	21,224	17,769	92,191	56,541	35,650	4,869	21,806	8,975
22	MEXICO	98,085	14,961	83,124	46,121	27,054	9,948	79,923	13,111	66,812	29,172	28,504	9,136
23	SWEDEN	81,065	47,780	33,284	13,296	4,872	15,116	84,198	49,397	34,802	16,874	4,601	13,326
24	BRITISH VIRGIN ISLANDS	77,707	46,120	31,587	11,978	3,723	15,886	75,094	46,692	28,402	10,938	2,890	14,573
25	NORWAY	74,707	42,633	32,075	3,118	5,394	23,562	68,211	37,317	30,894	8,484	5,922	16,488
TOTALS	TOP 25 + ALL OTHERS	7,779,249	2,431,201	5,348,048	1,980,140	1,131,467	2,236,442	6,864,260	2,143,885	4,720,375	1,882,379	940,631	1,897,364

Source: U.S. Department of Treasury Report On Foreign Holdings of U.S. Securities (Mar. 30, 2007).

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**FEDERAL RESERVE statistical release**

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Z.1

*Flow of Funds Accounts  
of the United States*

*Flows and Outstandings  
Third Quarter 2006*

**L.4 Credit Market Debt, All Sectors, by Instrument**

Billions of dollars; amounts outstanding end of period, not seasonally adjusted

	2001	2002	2003	2004	2005				2006			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	
<b>1 Total</b>	<b>29257.9</b>	<b>31726.6</b>	<b>34614.0</b>	<b>37703.7</b>	<b>38372.8</b>	<b>39181.3</b>	<b>39941.3</b>	<b>41041.4</b>	<b>41891.5</b>	<b>42712.0</b>	<b>43467.4</b>	<b>1</b>
2 Open market paper	1571.1	1507.6	1432.5	1567.2	1606.2	1668.5	1744.1	1833.9	1901.3	1960.9	2090.4	2
3 Treasury securities	3352.7	3609.8	4008.2	4370.7	4535.6	4493.1	4566.0	4678.0	4834.4	4759.6	4803.2	3
4 Agency- and GSE-backed securities	4989.1	5536.3	6108.1	6225.6	6177.9	6177.3	6165.0	6275.8	6387.2	6526.7	6557.7	4
5 Municipal securities	1603.5	1762.9	1900.5	2031.0	2085.7	2134.2	2176.1	2225.6	2254.9	2305.7	2337.5	5
6 Corporate and foreign bonds	5487.4	6121.5	6890.6	7675.0	7857.6	8082.9	8162.1	8358.4	8518.7	8721.3	8872.6	6
7 Bank loans n.e.c.	1424.3	1344.2	1283.9	1332.4	1353.5	1398.9	1423.9	1491.4	1547.3	1583.0	1623.7	7
8 Other loans and advances	1444.5	1464.7	1499.2	1590.2	1604.8	1666.5	1664.8	1707.2	1702.9	1760.4	1763.0	8
9 Mortgages	7485.6	8366.6	9373.9	10677.8	10935.7	11319.7	11751.1	12145.8	12450.8	12765.5	13033.1	9
10 Consumer credit	1899.6	2013.0	2117.0	2233.9	2215.8	2240.1	2288.1	2325.3	2293.9	2328.8	2386.2	10
<b>Memo:</b>												
<i>Selected claims not included above:</i>												
11 Corporate equities	15310.6	11900.5	15618.5	17389.3	17002.3	17185.9	17914.7	18277.0	19140.8	18668.9	19306.3	11
12 Mutual fund shares	4135.4	3638.4	4654.2	5436.3	5471.6	5595.7	5874.4	6048.9	6464.1	6420.0	6625.8	12

**L.5 Total Liabilities and Its Relation to Total Financial Assets**

Billions of dollars; amounts outstanding end of period, not seasonally adjusted

<b>1 Total credit market debt (from table L.4)</b>	<b>29257.9</b>	<b>31726.6</b>	<b>34614.0</b>	<b>37703.7</b>	<b>38372.8</b>	<b>39181.3</b>	<b>39941.3</b>	<b>41041.4</b>	<b>41891.5</b>	<b>42712.0</b>	<b>43467.4</b>	<b>1</b>
2 Official foreign exchange	46.8	55.8	62.3	62.2	56.3	54.3	52.0	45.9	46.0	48.3	46.5	2
3 SDR certificates	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	3
4 Treasury currency	24.5	25.5	26.0	26.7	26.9	27.2	27.4	27.5	27.6	27.8	28.1	4
5 Foreign deposits	810.1	831.1	867.8	957.7	1062.7	1010.0	1032.9	1044.5	1101.8	1161.7	1185.8	4
6 Net interbank liabilities	191.4	206.0	193.3	212.2	196.6	207.6	204.3	220.3	198.1	154.5	151.3	6
7 Checkable deposits and currency	1360.2	1351.9	1432.0	1521.8	1499.7	1514.6	1481.9	1525.0	1508.6	1538.5	1493.4	7
8 Small time and savings deposits	3370.5	3695.9	4001.7	4284.6	4376.0	4408.5	4523.7	4599.4	4688.7	4733.0	4791.4	8
9 Large time deposits	1121.0	1171.0	1232.8	1504.9	1575.4	1637.1	1738.0	1776.0	1876.1	1949.0	2053.7	9
10 Money market fund shares	2240.6	2223.9	2016.4	1879.8	1841.0	1831.5	1876.7	2006.9	2014.1	2067.4	2166.5	10
11 Security RPs	1233.7	1340.3	1567.5	1650.7	1782.8	1911.3	1983.9	2005.6	2127.7	2221.8	2371.4	11
12 Mutual fund shares	4135.4	3638.4	4654.2	5436.3	5471.6	5595.7	5874.4	6048.9	6464.1	6420.0	6625.8	12
13 Security credit	825.9	738.8	871.3	1037.9	1051.5	1064.5	1068.0	1030.2	1105.2	1147.9	1180.7	13
14 Life insurance reserves	880.0	920.9	1013.2	1060.4	1059.4	1067.2	1077.7	1082.6	1091.6	1092.6	1103.1	14
15 Pension fund reserves	8766.4	8068.0	9672.7	10636.8	10461.7	10666.5	10954.2	11176.7	11393.8	11271.4	11633.8	15
16 Trade payables	2372.3	2460.2	2485.2	2674.6	2721.6	2783.4	2867.6	2914.2	2950.5	3030.0	3087.5	16
17 Taxes payable	219.2	241.4	240.5	268.1	285.0	287.7	295.8	295.7	311.6	311.8	321.1	17
18 Miscellaneous	11281.6	11976.1	12431.7	13877.4	13895.1	14106.8	13878.6	13982.4	13807.0	13807.1	14043.7	18
<b>19 Total liabilities</b>	<b>68139.7</b>	<b>70674.1</b>	<b>77384.5</b>	<b>84798.0</b>	<b>85738.2</b>	<b>87357.6</b>	<b>88880.3</b>	<b>90825.3</b>	<b>92606.1</b>	<b>93697.0</b>	<b>95753.3</b>	<b>19</b>
<i>+ Financial assets not included in liabilities:</i>												
20 Gold and SDRs	21.8	23.2	23.7	24.6	22.6	22.3	19.3	19.3	19.4	19.7	19.7	20
21 Corporate equities	15310.6	11900.5	15618.5	17389.3	17002.3	17185.9	17914.7	18277.0	19140.8	18668.9	19306.3	21
22 Household equity in noncorp. bus.	4805.7	4970.0	5399.6	5957.7	6133.1	6357.7	6555.0	6739.9	6942.3	7055.0	7140.9	22
<i>- Liabilities not identified as assets:</i>												
23 Treasury currency	-8.6	-9.1	-9.5	-9.7	-9.6	-9.4	-9.0	-9.1	-10.3	-10.2	-10.0	23
24 Foreign deposits	630.9	652.5	705.9	767.9	864.1	803.3	808.9	813.2	873.9	941.0	972.1	24
25 Net interbank transactions	11.1	15.5	12.6	27.3	35.7	23.3	27.5	38.5	44.0	44.4	45.5	25
26 Security RPs	390.6	426.6	402.6	258.8	361.1	427.7	413.5	389.8	461.9	551.3	636.6	26
27 Taxes payable	93.3	126.3	69.3	96.2	91.9	97.0	80.8	95.4	93.1	74.3	56.7	27
28 Miscellaneous	-3450.2	-3269.9	-3026.9	-2878.7	-3117.5	-3104.3	-3451.4	-3378.6	-3599.6	-3853.0	-3827.7	28
<i>- Floats not included in assets:</i>												
29 Checkable deposits: Federal govt.	-12.3	-11.7	-17.9	11.2	4.9	1.7	2.8	1.8	1.5	1.5	2.7	29
30 Other	21.6	20.9	20.8	20.6	16.4	19.6	12.4	20.6	16.4	19.7	12.4	30
31 Trade credit	-140.5	25.3	64.9	58.9	-3.5	-34.9	-19.6	39.7	-11.3	-29.3	-24.8	31
<b>32 Totals identified to sectors as assets</b>	<b>90742.0</b>	<b>89591.5</b>	<b>100204.4</b>	<b>109817.1</b>	<b>110652.5</b>	<b>112699.3</b>	<b>115503.3</b>	<b>117850.0</b>	<b>120838.9</b>	<b>121700.8</b>	<b>124356.7</b>	<b>32</b>