



# China's Financial Weapons: U.S. Treasuries, the Yuan

## MARKETS

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The escalating trade conflict between the U.S. and China has reignited fears that Beijing could use financial markets to hit back at Washington.

China is one of the largest overseas owners of U.S. government debt. There have long been fears that China could dump the U.S. Treasuries that make up a large chunk of its foreign-exchange reserves. China owned about \$1.2 trillion in U.S. Treasury securities in January, according to estimates from Brad Setser, senior fellow at the Council on Foreign Relations. China's U.S. portfolio is difficult to track, because the government's use of third parties and custodians in places like Belgium obscures its ownership, according to Setser.

U.S. government data showed China owned about \$761 billion in Treasuries as of January, trailing only Japan. That data covers Treasuries held by both the government and private investors.

Some have speculated about whether China is behind this week's Treasury selloff. Goldman Sachs analysts said they were skeptical. The bank's analysts said that if Beijing or other central banks were offloading Treasuries, the dollar would be facing more pressure. Still, they said "shifts in the mix of reserve assets" is a risk for Treasury demand in the medium-term. \*

China could also use its currency. Beijing could devalue the yuan to help offset the impact of tariffs. The yuan's value is tightly controlled by the central bank, and investors have watched the daily "fix," where the value of the onshore currency is set, for signs policymakers are guiding it to weaker levels. The yuan fell to its weakest level in more than 17 years earlier this week, though it has rebounded back a bit in recent days.

A yuan devaluation could rattle global markets and encourage other countries to follow, reducing the value of their own currency to help their exports remain competitive. A yuan devaluation would also likely anger the Trump administration, because it would boost the dollar's value.

A devaluation could hurt China, too. Beijing's 2015 decision to devalue the yuan helped spark a wave of capital flight out of the country, though it subsequently tightened up capital controls.