Written by **Bob Adelmann** on July 8, 2010

From China, With Love

Addison Wiggin asked his readers to imagine an older happily married couple, having their usual morning breakfast together: They work well together, though maybe the lady of the house has been "the better half" lately … doing a larger burden of the work, paying more bills, keeping the house together and so on. But nevertheless, things are good, so it seems. Times are a little tough, but there's no imminent reason to suspect the relationship won't last.

Then one morning, [out of the blue!] she says, "Honey, I [just] want you to know that I'm *not* planning on divorcing you and taking [the] money with me."

On its website Wednesday, China's State Administration of Foreign Exchange (SAFE) announced that its "nuclear option" of selling large portions of their dollar-denominated assets was "completely unnecessary" and that "any increase or decrease in our holdings of US Treasuries is a normal investment operation." And then as an afterthought, SAFE added: "China has been calling for the US to genuinely take measures to protect investor's interests and confidence as a responsible nation." Or, as Wiggin might have put it: "I love you. And have a nice day."

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Three years ago China used the phrase "nuclear option" in a much more ominous comment from Xia Bin, the finance chief at the Development Research Centre that "Beijing's foreign reserves should be used as a 'bargaining chip' in [then current] talks with the United States. He Fan, an official at the Chinese Academy of Social Sciences, said: "China has accumulated a large sum of US dollars. Such a big sum, of which a considerable portion is in US treasury bonds, contributes a great deal to maintaining the position of the dollar as a reserve currency. [But] the Chinese central bank will be forced to sell dollars … which might lead to a mass depreciation of the dollar."

Simon Derrick, a currency strategist at the Bank of New York Mellon, said at the time that the comments were intended to be a warning: "The words are alarming and unambiguous. [They] carry a clear political threat and could have very serious consequences." Paul Craig Roberts, former Assistant Secretary of the Treasury in the Reagan administration, wrote that then, as now, "China controls US interest rates by its decision to purchase, hold, or dump US Treasury bonds." By making those simultaneous announcements, "China publicly called attention to Washington's dependence upon China's good will. By doing so, China signaled that it was not going to be bullied or pushed around."

China's foreign reserve holdings exceed $2 ½ trillion, with an estimated two-thirds invested in dollar-denominated assets. And since the start of the current financial crisis, as *Financial Times* pointed out, "Chinese leaders have publicly expressed concerns about the weakening dollar and rising US debt levels, calling on the US to pursue sound fiscal and monetary policies." And in a recent interview, Yu Yongding, an economist at the Chinese Academy of Social Sciences, said: "Even with the situation in

Europe, the bigger problem is still the US and its long-term debt position."

Call it a love note, or a gentle reminder, the veiled threat from China that it would be willing to use its vast dollar reserves as a "bargaining chip" in its dealings with the United States remains very clear. As Thomas Jefferson put it so many years ago: "There does not exist an engine so corruptive of the government and so demoralizing of the nation as a public debt. It will bring on us more ruin at home than all the enemies from abroad."