

## **Fears that China will abandon the Dollar are greatly exaggerated (as usual)**

Wednesday's reports that China was considering "slowing or halting" purchases of U.S. Treasury bonds reportedly prompted a sharp rise in Treasury yields on investor worries that the People's Bank of China (PBOC), the world's external largest holder of U.S. debt, might be ready to seek alternative assets. "Reports" because China immediately denounced the rumors as fake news and "reportedly" because there was no sharp rise in yields, only the usual daily variability.

While it is true that Treasury yields jumped to a nine-month high, the overnight jump of 4 basis points on January 10 was exactly the same as the overnight jump of 4 basis points on January 9, when there was no news from China whatsoever. These things happen. It's not even volatility. It's just normal background noise.

Which is not to say that China won't be selling American bonds. China's foreign currency reserves have declined by a trillion Dollars since 2014 (though they rose marginally over the course of 2017). Since China almost certainly holds most of its reserves in U.S. Dollars, it must have sold hundreds of billions of Dollars over the last few years. Tellingly, Treasury yields have hardly budged, while the trade-weighted exchange value of the Dollar has actually increased.

It's time to put to rest the idea that China can somehow destroy the U.S. economy or bring down the U.S. government by selling off its Dollar reserves. In fact, it's time to put to rest the idea that Dollar dominance is under any threat at all. The share of the world's declared foreign currency reserves that are held in US Dollars has been remarkably stable at around 65% for more than a dozen years. If anything, it's the Euro that's suffering

as countries diversify into new currencies like the Chinese Renminbi, not the Dollar.

The global dominance of the U.S. Dollar dates back to the time of World War One. There have been ups and downs over the years, but no serious challenges. In the late 1970s, pundits predicted that the Deutschmark would replace the Dollar, then in the late 1980s it was the Yen, and around 2000 it was the Euro. Now it's the Renminbi. Throughout it all, the Dollar has remained on top.

As long as China has currency reserves, it will keep them mainly in Dollars. China's leaders have little confidence in the Euro, and less in the Yen. They're certainly not going to hold Indian Rupees or Russian Rubles. There are only so many British Pounds and Swiss Francs available in the market. And in any case the Dollar is the common currency of Asia. Even the China-led Asian Infrastructure Investment Bank keeps its accounts and prices its debt in Dollars.

So the next time you see an alarmist report about China dumping the Dollar, just ignore it. When China builds currency reserves, it will buy Dollars, and when it spends reserves, it will sell Dollars. But buy or sell, the currency that matters in China will always be the U.S. Dollar. That's a prediction you can take to the bank — any bank in China. The People's Bank most of all.

*Salvatore Babones*

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