The Washington Post
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Bearish on Uncle Sam?

As Foreign Investment Shows Decline, Economists Keep Watch

By Jonathan Weisman *and* Ben White
Washington Post Staff Writers

NEW YORK—On Sept. 9, as it must frequently do, the U.S. government turned to Wall Street to raise a little cash, and Paul Calvetti bet that demand for $9 billion worth of long-term Treasury bonds would be "huge."

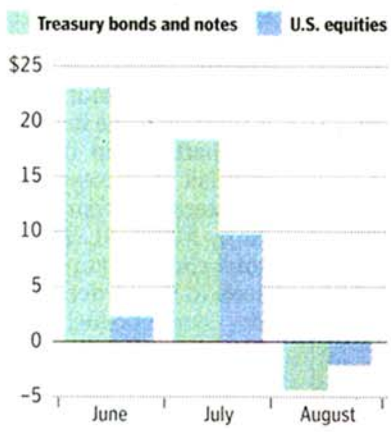
But at 1 p.m., as the auction opened and the numbers began streaming across his flat-panel screens, the head of Treasury trading at Barclays Capital Inc. slumped in his chair. Foreign investors, who had been voraciously buying Treasury bonds, failed to show up. Bond prices cascaded downward, interest rates rose, and in five minutes, Calvetti, 38, who makes money by bidding on bonds at one price and hoping market demand lets him quickly resell them at a profit, had lost $1.5 million.

"It's amazing," he gasped, after the Treasury Department announced that Wall Street traders, not foreigners, had been left to buy virtually the entire auction. "I don't think I've ever seen this before."

Foreign Interest

In the past few months, foreign investors have backed away from buying U.S. stocks and Treasury bonds.

Net foreign private purchases
In billions of dollars, for 2004



SOURCE: Treasury Department

THE WASHINGTON POST

The most recent auction of 10-year Treasury notes may have been a fluke, a momentary downturn in one aspect of the massive world market for U.S. government and private-sector bonds, stocks and other securities—a market so large and diverse that it has long been the world's safe haven. But a rash of new data, including Treasury Department figures released yesterday show-

See DEBT, E5, Col. 1

The New York Times

TUESDAY, OCTOBER 19, 2004

Private Investors Abroad Cut Their Investments in the U.S.

By EDUARDO PORTER

The flow of foreign capital contracted in August as private investors lost some of their appetite for American stocks and bonds, underscoring the United States' increasing dependence on financing from central banks in Asia.

The Treasury Department reported yesterday that net monthly capital flows from the rest of the world fell for the sixth time this year, declining to $59 billion from $63 billion in July.

Private investment from abroad fell by nearly half — to $37.4 billion in August from $72.9 billion the month before. Investors appear to be concerned over cooling growth and a rising American trade deficit.

Asian central banks bail out America, a nation of spenders rather than savers.

The only reason that the contraction was not more pronounced was that official financing, mainly from Asian central banks, jumped to nearly $23 billion in August from just over $6 billion in July.

Washington has demanded that China end a policy of buying dollars to reduce the value of its currency, the yuan, and make its exports more competitive in American markets. But the new data accentuated how dependent the United States has become on purchases of dollar securities by the Chinese and other Asian governments with links to the dollar.

"Foreign central banks saved the dollar from disaster," said Ashraf Laidi, chief currency analyst of the MG Financial Group. "The stability of the bond market is at the mercy of Asian purchases of U.S. Treasuries."

Net foreign purchases of United States Treasury bonds fell 35 percent, to roughly $14.5 billion, an 11-month low. Foreign governments left a particularly large footprint in this market, stepping up their net purchases to about $19 billion even as private investors sold about $4.5 billion worth.

Holdings of Treasury bonds by Japan, where the central bank has also been intervening to keep the value of its currency from rising, increased by $26 billion in August, to $722 billion. Chinese official holdings rose more than $5 billion, to $172 billion.

The decline in foreign investment seems to have unsettled some investors in the bond and currency markets, who have been on tenterhooks as the American trade deficit has soared to nearly 6 percent of the nation's economic output, requiring foreign investment to finance it.

Through the first quarter of the year, financial flows into the United States exceeded the trade deficit by well over 50 percent. Last month, they barely covered the $54.2 billion deficit.

As private capital flows declined, the American financial balance has been poised precariously. As private financing dwindled, most of this coverage has been provided by foreign government finance.

"If all we have funding our current account imbalance is the good graces of foreign central banks, we are on increasingly thin ice," said Stephen S. Roach, the chief economist at Morgan Stanley. Of Washington's call for China to stop interfering in currency markets, he cautioned, "That could come back and bite us."

Not all economists are that worried about the growing shortfall in the current account, the broadest measure of trade, pointing out that it is sustainable as long as Asians continue on a path of export-led growth that requires cheap currencies against the dollar.

Many economists stress, however, that this symbiotic balance between Asian and American economies will eventually come to an end.

Jeffrey Frankel, an economics professor at Harvard University, said: "The Asians are going to go on buying Treasury securities for a while, preventing the dollar from depreciating and helping keep U.S. interest rates low, which is a good thing. But not forever."

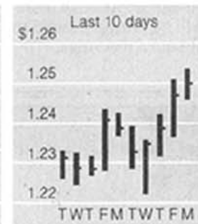
Morris Goldstein of the Institute for International Economics remarked, "This can be a story for one year or two years, not for 10 years."

If the United States were to temper its appetite for foreign money, the Chinese and Japanese could curtail their purchases of American securities without causing financial havoc. The dollar could then drift lower against Asian currencies, benefiting American exporters and manufacturers that compete with Asian imports.

But this would require Americans to increase their rate of savings. Household savings have plummeted to only 1.5 percent of personal income, from 11 percent 20 years ago. With the federal government running a budget deficit of 3.5 percent of the nation's output, the public sector hardly contributes to savings.

A disorderly situation would occur if foreign money dried up suddenly when the United States still needed it. Then, the adjustment in American savings might happen involuntarily. Interest rates would rise sharply, and the dollar could fall abruptly. This could induce a sharp economic contraction, even stagflation.

"The longer we wait," Mr. Goldstein said, "the more likely we'll have the adjustment anyway. But the adjustment will be more chaotic and sharper."



Sources: Bloomberg Financial Markets; Associated Press

The New York Times

CURRENCY	YESTERDAY CLOSE	YESTERDAY CHANGE	YEAR TO DATE	52 WEEKS
British pound (in U.S. dollars)	1.7992	– .0042	+ .89%	+ 7.41%
Canadian dollar (per U.S. dollar)	1.2558	+ .0040	– 2.52	– 4.39
Euro (per U.S. dollar)	.7999	– .0014	+ .57	– 6.85
Japanese yen (per U.S. dollar)	109.27	+ .08	+ 1.78	– .09
Mexican peso (per U.S. dollar)	11.4480	– .0070	+ 1.97	+ 2.03
South Korean won (per U.S. dollar)	1145.48	+ .08	– 3.95	– 2.30
U.S.DOLLAR INDEX	87.12	– .04	– .16	– 6.05

Foreign Creditors May Be Starting to Look Elsewhere for Investment

"... [A] rash of new data, including Treasury Department figures released yesterday showing a net sell-off by foreigners of U.S. bonds in August, has stoked debate over whether overseas investors – private individuals, institutions and government central banks – are growing dangerously bearish on the U.S. economy."

– *Washington Post*, "Bearish on Uncle Sam? As Foreign Investment Shows Decline, Economists Keep Watch"
October 19, 2004

Large Amount of Foreign-Held Debt Could Lead to Economic Turmoil

“A turn in overseas attitudes toward the United States could ripple deeply through the economy, depressing the market, raising interest rates and pushing down the value of the dollar.”

– *Washington Post*, “Bearish on Uncle Sam? As Foreign Investment Shows Decline, Economists Keep Watch”
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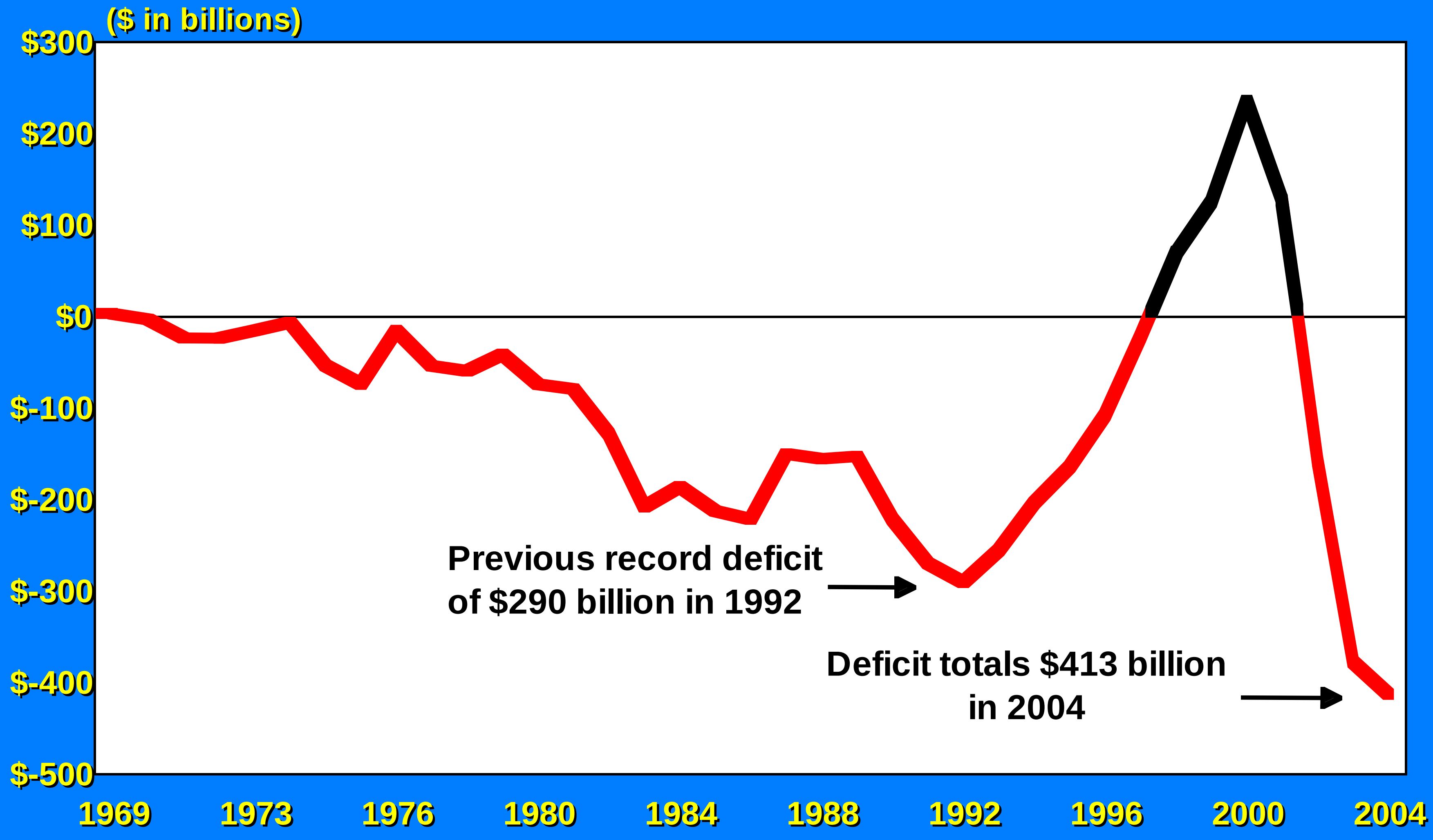
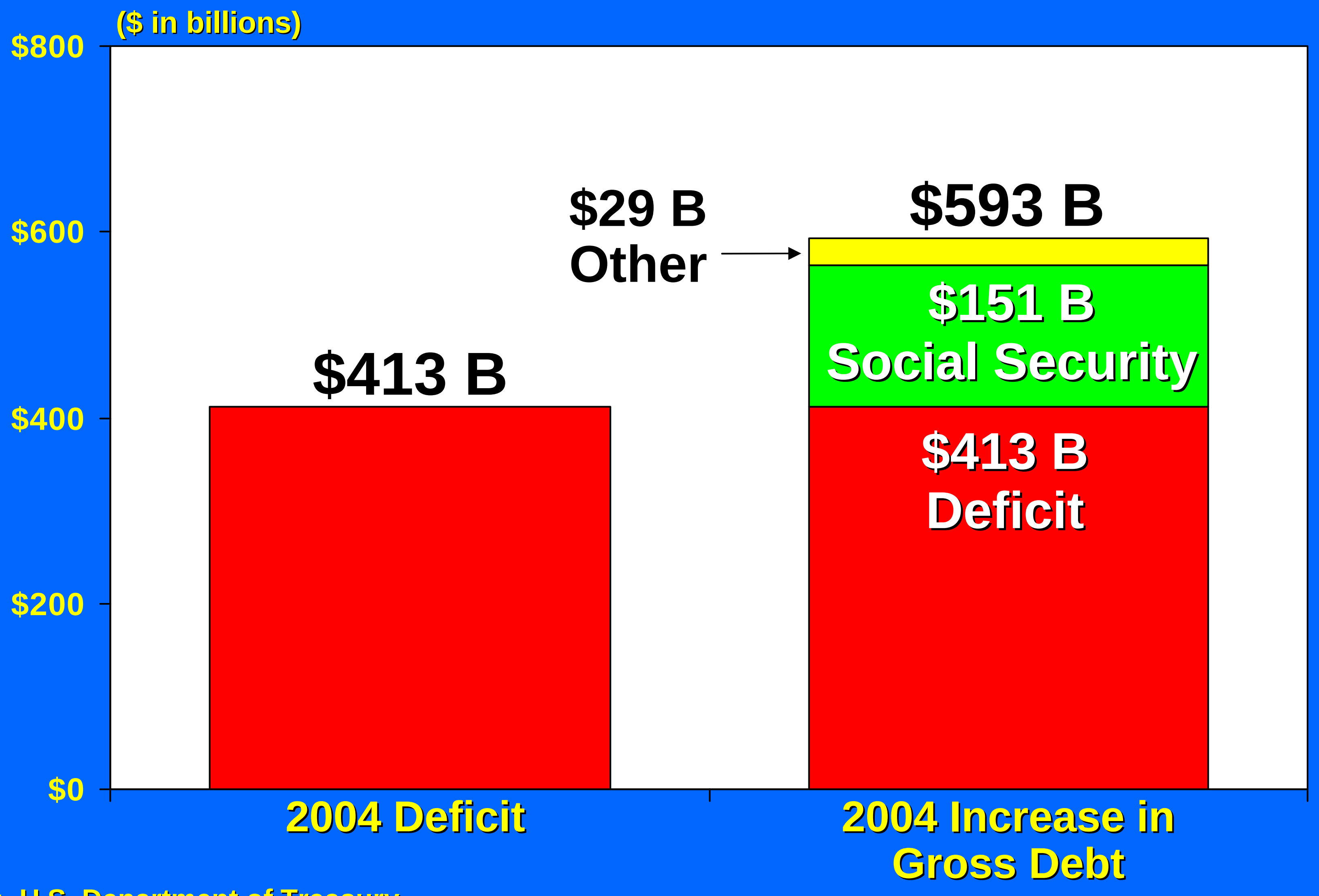
Deficits in 2003 and 2004 Far Exceed Previous Record in Dollar Terms



Source: U.S. Department of Treasury

Oct 15

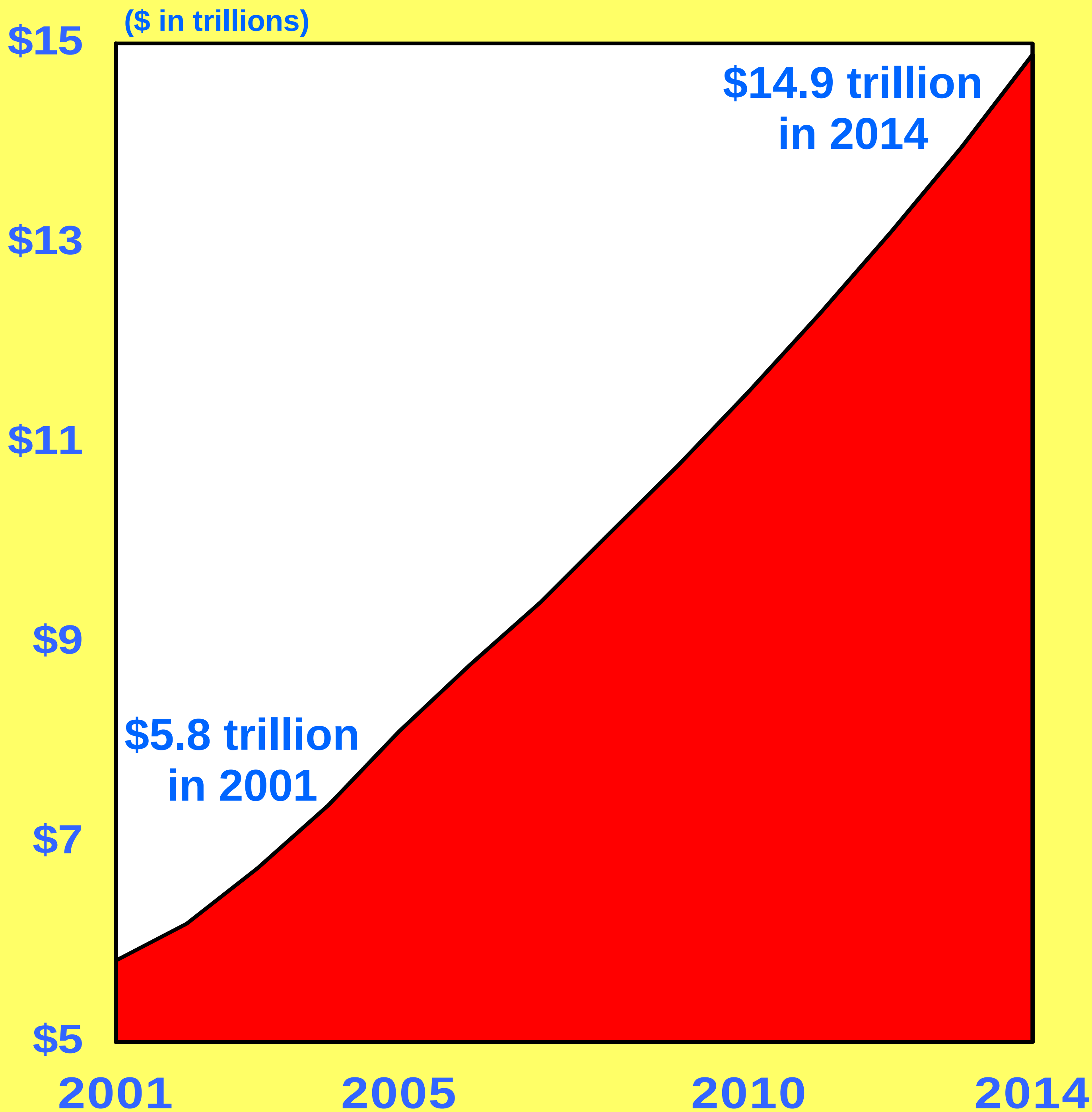
Increase in Debt in 2004 is Far Greater Than the $413 Billion Deficit



Source: U.S. Department of Treasury

Gross Federal Debt

Assuming Bush Tax Cuts Made Permanent, Bush Defense Buildup, AMT Reform, and Ongoing War Costs



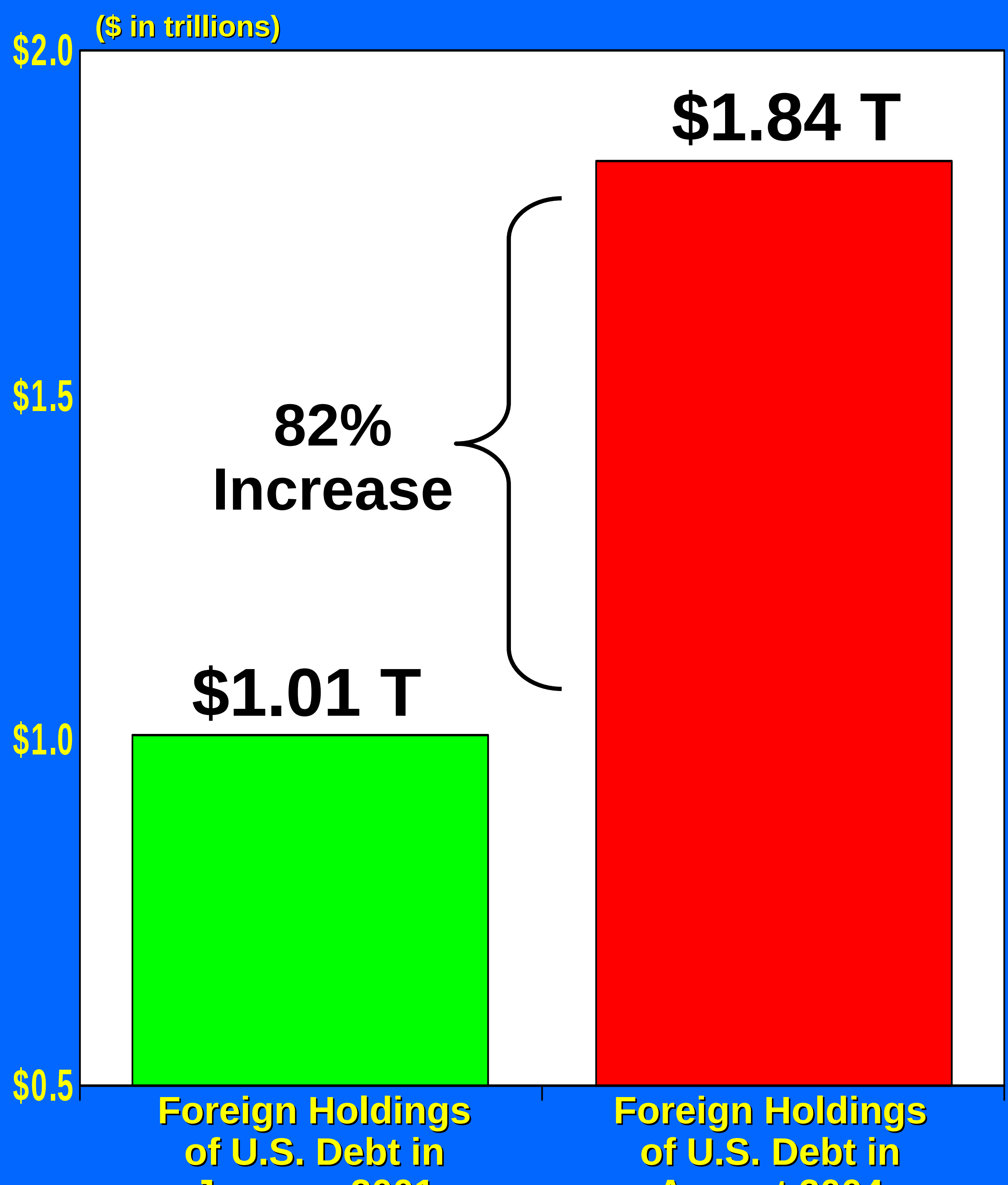
Source: CBO, SBC, and U.S. Department of Treasury
Note: CBO September 2004 estimate with Bush tax cuts made permanent, Bush defense buildup, AMT reform and CBO estimate of ongoing war costs.

Top Ten Countries Holding Our National Debt

Japan	$722 B
China	$172 B
United Kingdom	$135 B
"Caribbean Banking Centers"	$91 B
South Korea	$63 B
Taiwan	$56 B
Hong Kong	$49 B
Switzerland	$49 B
Germany	$48 B
OPEC	$43 B

Source: Department of Treasury
Note: As of August 2004

Foreign Holdings of U.S. Treasury Debt Have Increased 82 Percent Under President Bush



Source: U.S. Treasury

Former Fed Chairman Volcker Believes Large Amount of Foreign-Held Debt Increases Chance of Currency Crisis

"[Former Federal Reserve Board Chairman Paul Volcker] said in response to a question about the likelihood of a currency crisis in the near future that he believes there is a '75 percent' chance of such a crisis, which could be fueled by a decision by other nations to reduce their purchase of U.S. securities."

– *BNA*
October 29, 2003