The Dollar and the New Bretton Woods System[1]

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It is an honor and a pleasure to be here at the Cass School to deliver the Thornton Lecture. Henry Thornton, as some of you know, made a number of important contributions to the literature on the international monetary system. This is a topic, the operation of the international system, that has been somewhat out of fashion in recent years, at least in academia. Now it is back, of course, with a vengeance.

The title of my talk is a variant of the title of an NBER working paper I put out last May, entitled "Global Imbalances and the Lessons of Bretton Woods," in which I predicted a significant decline in the dollar "sooner rather than later."[2] You can see that I followed the first rule of forecasting: give them a forecast or a date, but never both. In light of recent events, my talk this evening is an opportunity to say I told you so and to explain why. In addition, I want to indicate how my thoughts on these matters have evolved over the last six months, and to offer a prediction for the future.

My starting point is with the influential school of thought that views the current international monetary and financial system as Bretton Woods reborn.[3] Its story goes like this. Today, like 40 years ago, the international system is composed of a core and a periphery. The core has the exorbitant privilege of issuing the currency used as international reserves and a tendency to live beyond its means. The periphery, which still has a way to go in catching up to the core, is committed to export-led growth based on

[1] Text of the Henry Thornton Lecture delivered at the Cass School of Business, 15 December 2004.
[2] Barry Eichengreen, "Global Imbalances and the Lessons of Bretton Woods," NBER Working Paper no. 10497 (May 2004).
[3] Michael Dooley, David Folkerts-Landau and Peter Garber, "An Essay on the Revived Bretton Woods System," NBER Working Paper no.9971 (September 2003).

the maintenance of an undervalued exchange rate, a corollary of which is its massive accumulation of low-yielding international reserves issued by and denominated in the currency of the center country. In the 1960s, the core was the United States and the periphery was Europe and Japan, many developing countries not yet having been fully integrated into the international system. Now, with the spread of globalization, there is a new periphery, the emerging markets of Asia and Latin America, but the same old core, the United States, with the same tendency to live beyond its means. The main difference between now and then, aside from the names of the players, is the existence of a third bloc, Europe, which has neither the periphery's scope for catch-up nor the reserve-currency country's ability to live beyond its means, which is why it feels under pressure.

This view yields strong predictions. It suggests that the current pattern of international settlements can be maintained indefinitely. The United States can continue running current account deficits because the emerging markets of Asia (and Latin America) are happy to accumulate dollars. There is no reason why the dollar must fall further, since there is no need for balance of payments adjustment; in particular, the Asian countries will resist the appreciation of their currencies against the greenback. That China has as a rural population of 200 million underemployed workers yet to be absorbed into the modern sector, something that it can do at the rate of only 10 million to 20 million a year, suggests that it will remain committed to its strategy of export-led growth for a decade and perhaps even two. The current pattern of exchange rates and international payments can be preserved for at least as long.

This way of viewing the pattern of international settlements and the structure of the international monetary and financial system has much to recommend it. For one thing, it encourages us to consider how national balances of payments fit together as interdependent elements of a larger system. Systemic analyses were once commonplace in the literature on the international monetary and financial system; in recent decades they have fallen out of fashion, as I've said. Proponents of the new view should be commended for reminding us that there is such a thing as the international monetary *system* and of the fact that the global balance of payments (inclusive of reserve changes) must sum to zero, something that should have implications for how we think about the world.

In addition, this new view helps us to understand how the current pattern of global imbalances arose in the first place. Low U.S. savings rates are part of the story, but Asian policies are another. Asian countries have long been committed to policies of export-led growth. Pegged exchange rates and resistance to pressures for revaluation as their economies and current accounts strengthen have been at the center of their development strategies. In pursuing this approach China is following in the footsteps of the newly industrializing economies of East Asia which are themselves following in the footsteps of Japan. There is no question that their accumulation of reserves is a concomitant of intervention in the foreign exchange market to keep their currencies down, which is in turn a concomitant of the strategy of promoting exports as a way of stimulating growth. If this means lower incomes and living standards for the time being, relative to those that could be achieved in the short run if currencies were allowed to appreciate, then this is perfectly fine so long as it translates into faster growth and even higher living standards down the road.

The analogy with Europe in the 1950s and 1960s is direct. I myself have characterized the European social compact in this period as a willingness to trade wage restraint and accept lower levels of consumption in return for faster investment and export growth rates that promised to deliver significantly higher living standards down the road. Other authors have emphasized the role of the same factors in the high-growth period in Japan. Exchange rates that were increasingly undervalued as the period progressed were integral to this process.

There is no question that the United States plays a unique role in the international monetary and financial system today, as it did 40 years ago. It has been able to run persistent current account deficits without seeing the dollar fall significantly against the currencies of the periphery because the latter are concerned to preserve their position in the U.S. market. This prompts countries in the periphery to intervene with purchases of dollars in order to keep their exchange rates from appreciating. Their willingness to accumulate reserves is a consequence of expanding economies and expanding trade. It is reinforced by a lesson drawn from the emerging market crises of the 1990s, namely that the world is a risky place and that governments must insure against sudden shifts in financial flows.

In turn, these policies affect the incentive for the United States to adjust its policy mix. It feels less pressure rein in public spending – to choose between guns and butter in the 1960s terminology – because the additional dollar-denominated securities that it is pumping into the world economy are happily absorbed by Asian central banks. The result is less dollar depreciation and less imported inflation. This means less pressure on the Fed to raise interest rates, relieving the central bank of the need to choose between price stability and growth- and employment-friendly monetary policies. The federal government, enjoying low funding costs, can have its cake and eat it too, boosting spending on both defense and social programs without having to resort to tax increases.

So much for praise. My argument tonight is that this image of a new Bretton Woods System is a misleading way of thinking about the prospects for the international monetary and financial system in the 21st century. It confuses the incentives that confronted individual countries under Bretton Woods with the incentives that confronted groups of countries. Even if it was in the collective interest of Europe (and Japan) to keep their currencies down against the dollar to export their way to growth, each individual European country had an incentive to convert dollars for gold if it could get away with this and thought that it would not necessarily provoke the others to do the same. In practice, it was the French to displayed the least patience and the Germans would held out until the bitter end, ultimately at considerable cost.

To finesse this problem, the new view imagines the existence of a cohesive bloc of countries called the periphery ready and able to act in their collective interest. The idea that such a cartel existed in the 1960s is not entirely farfetched; it was called the Gold Pool. The Gold Pool was established in 1961. It was an arrangement whereby central banks sought to share the cost of maintaining the London price of gold at $35 an ounce rather than depleting U.S. gold reserves. It encouraged collective action by establishing an understanding of how the costs of these operations would be divided – that is, of what share of the gold that needed to be sold in London in order to stabilize the market price would be provided by each participating central bank. It collapsed in 1968 after French gold purchases became known and was followed by a short-lived

Gentleman's Agreement that collapsed in 1970, an event that was followed in short-order by the collapse of the Bretton Woods System itself.

Thus, history shows that this cartel, like most cartels, proved impossible to hold together when the need was greatest – that is, when collective action was needed for the maintenance of the system. I will argue that the same point applies today: that the countries of Asia constituting the new periphery are similarly unlikely to be able to subordinate their individual interest to the collective interest. Even if it is in their collective interest to hold dollars to keep their currencies down and the dollar up, it is in each of their individual interests to get out before the bottom falls out of the U.S. currency. This, then, is a classic cartel problem.

There is now plenty of evidence of this cartel at least fraying at the edges, as Asian central banks anticipate ongoing U.S. current account deficits going forward as far as the eye can see, now that President Bush has been elected. Until recently, the main form that this behavior took was Asian central banks moderating their further accumulation of dollars. The next slide shows you that this was true through the first nine months of 2004 for essentially every Asian central bank but Japan (which has been engaging in massive foreign exchange market intervention to keep the yen from appreciating).

Now, however, portfolio diversification may be underway as the cartel begins to weaken. Let me give you some evidence suggestive of this. My favorite example is the following extract from ING's "Economics and Strategy Weekly" a few weeks ago (Figure 1):

"US marketable securities held in custody by the Fed for foreign and institutional accounts, which is viewed as measuring foreign central bank holdings of US Treasuries, dipped $3.9 billion in the week ending 13 October. While small in absolute size any dip has been more the exception than the rule over the last couple of years. Seen in light of Asia's foreign exchange reserve accumulation – note China's reporting of a $19 billion increase in reserves in September – the recent data suggests cheating by members of the cartel of Asian central banks that seek to keep their currencies undervalued against the US dollar as part of their export-led growth strategy. While all cartel members want to reduce US Treasury and US dollar risk, they cannot collectively without undermining their growth strategy. Most cartels collapse because the incentive to cheat eventually proves irresistible. A sustained bout of US dollar weakness could be what breaks Asian central banks of the addition to US Treasuries. If that happens the giant sucking sound will be money out of Treasuries and the US dollar."

Or this one, from the same source a few weeks later (Figure 2): "The week ends with the US dollar and Treasuries being sold off on a report that China sold $180 million of Treasuries to reduce their exposure to dollar assets….Or is Korea the first to leave the dollar bloc? Given their scale of exchange market intervention in the past two years the Bank of Korea's failure to intervene aggressively is a special source of wonder. The Korean won has appreciated by 10 per cent this year….It's stronger than any time since late 2000. Some predict that the high costs of intervention eventually will lead individual Asian countries to abandon the policy of maintaining undervalued currencies. [The cost of intervention refers to the low interest rate on the U.S. Treasuries that the Bank of

Korea has to buy, relative to the interest rate on the won securities it sells – and to the prospective capital losses.] Korea may be the leading edge of this."

Or this one, from the *Financial Times* on November 29th (Figure 3). "The fragility in currency and bond markets has centered on fears that Asian central banks might dump US assets to avoid large losses as the dollar's value falls. The markets' nerves were highlighted by Friday's investor reaction to a report, later retracted, that China's central bank was offloading US Treasury bonds." Note also the accompanying commentary from Tom Gallagher that this is probably more than a rumor.

One can also imagine a geopolitical spin on these same issues. Recall that in the 1960s it was the Germans who most patiently supported the dollar and French who pulled the plug. Germany was willing to support the dollar because it saw doing so as part of a geopolitical bargain. Given the lack of a standing army, Germany depended for its defense, and deterrence of the Soviet Union, on U.S. troops on the ground in Europe. Those U.S. troop commitments were a drain on the U.S. balance of payments, so Germany's part of the bargain was to absorb dollar liabilities and patiently support the dollar. On this, I recommend to you if you haven't seen it Francis Gavin's new history of the Bretton Woods System.[4] France, in contrast, was much less enamored of NATO and not deterred from selling dollars by the need to cultivate U.S. good will and discourage the redeployment of U.S. troops away from Europe.

In the present context, one could well imagine other countries that are not particularly fond of U.S. foreign policy initiatives in the Middle East selling dollars as a way of expressing their displeasure and increasing the effective cost to the United States

[4] Francis Gavin, *Gold, Dollars and Power: The Politics of International Monetary Relations, 1958-1971,* Chapel Hill: University of North Carolina Press (2004).

of its military adventures abroad. Hypothetically, one thinks of Asian countries with large Islamic populations like Indonesia. One thinks of China, although the catalyst there would more likely be Taiwan. One thinks of the OPEC countries of the Middle East. Actually, this last case may not be so hypothetical. Let me put up a graph from JP Morgan's "Global Currency Research" (the November 30th edition), that seems to make this point (Figure 4). I am not saying that this is a major factor in the dollar's weakness, yet, but one could well imagine this becoming an additional factor.

In addition, there may come a point where China and other Asian countries grow fed up with subsidizing the ability of the United States to buy up their corporation and to establish joint ventures on the cheap. There is a version of the "new Bretton Woods" story which suggests that the current pattern of global imbalances is a way of circumventing the inefficiencies of the Chinese banking system.[5] They buy U.S. Treasury bonds, and we use the funds to engage in direct foreign investment in China. In effect, this is simply a transfer of funds from Chinese households and the government to the most efficient sectors of Chinese industry, which are identified by U.S. investors, while avoiding an inefficient Chinese banking system. Perhaps, but this is not all that is going on. The other element is that the artificially high dollar enables U.S. investors to scoop up productive capacity in China at bargain-basement prices. This is what got Charles De Gaulle all hot and bothered when he complained of America's "exorbitant priviledge" – foreign support for the dollar and the greenback's role in the Bretton Woods System was artificially subsidizing the "invasion" of Europe by U.S. multinationals. This was another element in the French decision to pull the plug on Bretton Woods. One

[5] Michael Dooley, David Folkerts-Landau and Peter Garber, "Direct Investment, Rising Real Wages and the Absorption of Excess Labor in the Periphery," NBER Working Paper no. 10626 (July 2004).

wonders, obviously, whether it could happen again. And it provides a rather different perspective on how long Asian central banks and governments will remain willing to subsidize U.S. foreign direct investment.

What else could bring down the cartel? Recall the very first slide which showed that Japan was the only Asian country whose holdings of U.S. Treasuries have been growing significantly faster than its accumulation of reserves, as the Bank of Japan intervenes in the foreign exchange market to prevent the yen from rising against the dollar and torpedoing Japan's tepid recovery. The rest of the cartel has, in effect, been free-riding on Japan. If the Japanese authorities ever conclude that the recovery is for real and become sufficiently confident about its robustness to let their currency float, that could spell doom for the dollar. This, of course, is just what happened at the beginning of the 1970s. Germany had long been committed to pegging its exchange rate as a mechanism for supporting its export-led growth. At the beginning of the 1970s it concluded that it no longer needed this crutch.

The other way that this picture of a new Bretton Woods System misleads, I wish to argue, is that it underestimates how dramatically the world has changed. First, the members of the periphery are more numerous and heterogeneous today than in the 1960s. Back then we were talking about Europe and Japan. The countries of Europe had a shared historical experience and had already moved down the road toward building institutions to facilitate collective action and transnational governance. In today's Asia, in contrast, stages of economic development and hence policy priorities are less homogeneous. This makes defining the collective interest more difficult. Moreover, regional cooperation is more weakly institutionalized than in Europe even 40 years ago.

All this renders dubious the assumption that Asian countries will collectively work to maintain the status quo.

Second, shifting out of dollars is only as attractive as the next best alternative. By the mid-1960s U.S. monetary gold reserves had fallen to barely half the $25 billion reached in the second half of the 1940s. Globally, gold was in inelastic supply. Sterling, the second most important reserve currency, was hardly an attractive alternative. Whether or not central banks liked this situation, it lent stability to the prevailing international system. Now, in contrast, there is the euro. Need I say more?

Third, the readiness of foreign central banks to hold onto dollars and the cohesiveness of their cartel depend on their perception of the reserve-currency country's commitment to maintaining the value of their claims. Under Bretton Woods there was a putative commitment to maintain the dollar's convertibility into gold at a fixed price. At least there was until LBJ was succeeded by Richard Nixon, Nixon and his eventual Treasury Secretary John Connolly being much less concerned than their predecessors with maintaining the value of the dollar. You will remember the famous quotes: from Connolly, ""The dollar may be our currency, but it's your problem." "Foreigners are out to screw us, and it is our job to screw them first." And also some from Nixon that I will not repeat in this polite company.

The timing of events – Nixon takes office and abandons his predecessor's strong-dollar policy, following which the Gold Pool falls apart, is suggestive of what we are going through now. Moreover, the prospects for the dollar maintaining its value against foreign currencies are also more dubious than they were in the 1960s to the extent that U.S. external deficits today reflect the country's low savings rate, which does not bode well for the future sustainability of its debt at current price levels. In contrast, the dollar problems of the 1960s at least took place against the backdrop high savings rates, which had more favorable implications for debt sustainability.

Fourth, the removal of capital controls makes it harder to bottle up private financial transactions which apply pressure to the current constellation of exchange rates. This forces central banks today to undertake more extensive, more costly, and more difficult sterilization and intervention operations in order to maintain the status quo.

Fifth, the liberalization of domestic financial markets means that keeping the exchange rate low and domestic savings high no longer guarantees that additional investment will be centered in the traded goods sector. In the present deregulated financial environment there is a tendency for loose credit conditions to pump up investment in nontradables, notably property, fueling building booms and heightening financial fragility. Asian governments are increasingly aware that the current strategy entails these risks, creating an incentive to modify it sooner rather than later.

The final point is that Asian policy makers are not ignorant of this history. Bretton Woods reminds them of Herb Stein's adage that something which can't go on forever generally won't. (It is traditional to always quote Herb Stein at this point.) In addition they are aware, precisely because of the historical experience referred to above, that a policy of export-led growth has not just benefits but also costs. They are seeking to build more diversified economies that rely on domestic demand as well as exports. South Korea, which has sought to stimulate the growth of consumer credit, is a prominent, if not entirely reassuring example (since the initiative soon led to a crisis in the credit-card industry). China is another case where consumption and not exports are now the most rapidly growing component of aggregate demand.

What, then, does this imply for the future?[6] Congenital optimists see the dollar's fall as part of a necessary rebalancing of the world economy. Absent a change in exchange rates, the U.S. current account deficit is on an explosive path. It could widen from its current 5-6 per cent of U.S. GDP to 8 per cent in 2008 and 12 per cent in 2010. In reality, deficits of this magnitude are not something that foreigners would willingly finance, especially insofar as they reflected chronic budget deficits rather than high levels of private investment. At some point foreign investors would pull the plug, and the dollar and the U.S. economy would come crashing down. A smooth and moderate decline in the dollar that narrows the U.S. current account now is thus the preferable alternative to a sudden and potentially catastrophic fall later.

The question is whether it is already too late for a smooth adjustment. The current account is the difference between savings and investment. Narrowing the U.S. deficit will therefore require some combination of increased savings and lower investment. The falling dollar will bring this about by putting upward pressure on interest rates. As Asian central banks curtail their purchases of U.S. treasury securities and sell some of their existing holdings, there will be upward pressure on U.S. treasury yields.

Moreover, as the dollar falls, there will be upward pressure on U.S. import prices and more inflationary pressure generally. In response, the Fed will have to raise interest rates faster than currently expected. Higher interest rates will make borrowing more expensive and slow investment growth. They will have a negative impact on asset

[6] This part of the lecture draws heavily on my opinion piece in the *Financial Times* (20 December 2004), or perhaps I should say that my opinion piece in the *FT* draws heavily on this lecture!

valuations, including housing prices. U.S. households, no longer living off of capital gains, will have to start saving again. With investment down and saving up, the current account deficit will narrow.

Unfortunately, this happy observation is not the end of the story. A significant decline in both consumption and investment will mean a recession in the United States. This conclusion is so obvious that the only question is why the markets are not forecasting it already.

The answer, presumably, is that investors don't believe that the dollar's decline will produce a significant increase in inflation. The historical data say that a 10 per cent fall in the dollar produces 3 additional percentage points of inflation, which in turn implies a 450 basis point increase in the discount rate. Clearly, we haven't seen anything like this yet. TIPs spreads – the difference between yields on conventional treasury securities and Treasury Inflation Protected Securities – suggest only a modest increase in inflationary expectations. Maybe the New Economy has rendered the U.S. economy more flexible and resilient so that the traditional relationship between dollar depreciation and inflation no longer holds. Perhaps then fears of significantly higher interest rates are exaggerated.

But even if this observation is correct, it just means that the dollar will have to fall further to generate enough inflationary pressure to force the Fed to raise interest rates. At the root of the dollar's current decline is the view that the U.S. current account deficit is unsustainable. Foreigners will therefore keep selling dollars until it narrows. This in turn means that the dollar will keep falling until U.S. inflation heats up to the point where the

Fed does indeed have to raise interest rates. The implication, that U.S. economy will slow or more likely succumb to recession, is unavoidable.

The question is whether there is anyone to take up the slack. For the world economy to avoid a serious downturn, less consumption and investment in the United States will have to be offset by more consumption and investment elsewhere. Indeed, if there is enough additional demand coming from abroad, the U.S. could avoid recession as well, since the lower dollar would crowd in more exports to offset the decline in domestic consumption and investment. But where will that additional demand come from? Europe is stagnant, and the ECB has shown no awareness of the need for monetary stimulus. China is cooling off, and it will cool off more as it allows its currency to strengthen. Japan's modest recovery will disappoint now that it has to raise taxes to control its own spiraling debt. Countries outside the G-4 are simply too small to make a difference.

The implication is that the correction of the U.S. current account deficit now getting underway will mean a recession not just for the United States but for the rest of the world. It is interesting that a piece on this very issue by Raghuran Ragan, economic counselor and head of the research department at the IMF, appears in the *Financial Times* today.[7] Mr. Rajan argues that averting a global recession and breaking the dollar's fall will requires contributions from the United States, Europe and Japan. The U.S. should cut its fiscal deficit to restore confidence. Europe should make its markets more flexible to stimulate growth. Asia should let its currencies appreciate to boost the quality and quantity of investment. Alas, I've got bad news for Mr. Rajan. The U.S. under this

[7] Raghuran Rajan, "Credible Policies Will Break the Dollar's Fall," *Financial Times* (15 December 2004), p.A15.

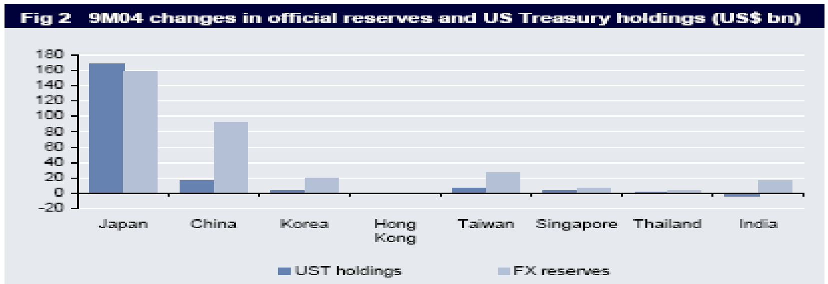
administration is not going to be raising taxes in order to cut the budget deficit anytime soon. More flexible labor markets in Europe, while a good thing in the long run, will only heighten job insecurity and lower consumer confidence in the short run. And currency appreciation in Asia, while another good thing for the long run, will reduce rather than augment the volume of investment in the short run by slowing growth and squeezing profits. If this is the best that the Fund can do under the circumstances, I'm not reassured.

On this happy note, I would be pleased to take your questions.

Little evidence yet of Asian central banks actively selling dollars, but aside from Japan their accumulation has slowed (ING "Economics and Strategy Weekly," Dec. 7)

Central banks in Asia ex-Japan have been cautious about increasing their exposure t
Treasuries and the US dollar. Apart from Thailand, foreign reserve accumulation in th
rest of the region far exceeds UST purchases. For example, China accumulated US
16.4 bn of Treasuries in 9M04, less than 20% of its total foreign exchange reserv
accumulation (Figure 2). Central banks in Asia ex-Japan have been free riding off th
Bank of Japan's efforts to slow the dollar's decline and hedging their exposure to US
and USD risk by investing their reserves in non-USD denominated assets.

Fig 2 9M04 changes in official reserves and US Treasury holdings (US$ bn)



Source: CEIC, US Treasury TIC system data

Offers to sell USD/CNY are getting bolder and bolder. We have turned more bullish on China's 4Q growth prospects, which we see as consistent with a higher probability of CNY revaluation before the end of the year.

A crack in cartel discipline?

US marketable securities held in custody by the Fed for foreign official and institutional accounts, which is viewed as measuring foreign central bank holdings of US Treasuries, dipped US$3.9bn in the week ending 13 Oct (Figure 1). While small in absolute size, any dip has been more the exception than the rule over the last couple of years.

Fig 1 Are some Asian central banks cheating?

Source: Bloomberg

Seen in light of Asia's foreign exchange reserve accumulation – note China's reporting of a US$19bn increase in reserves in September – the recent data on US Treasury holdings suggests cheating by members of the cartel of Asian central banks that seek to keep their currencies undervalued against the US dollar as part of their export-led growth strategy. While all cartel members want to reduce US Treasury and US dollar risk, they cannot collectively without undermining their growth strategy. Most cartels collapse because the incentive to cheat eventually proves irresistible. A sustained bout of US dollar weakness could be what breaks Asian central banks of the addiction to US Treasuries. If that happens the giant sucking sound will be money out of Treasuries and the US dollar.

Source: ING "Economics and Strategy Weekly"

Or consider this from the end of November (same source)

This week's highlights – China diversifying away from US dollars? The week ends with the US dollar and Treasuries being sold off on a report that China sold USD 180 mn of Treasuries to reduce their exposure to USD assets. Asian central banks cannot sell US dollar assets without undermining their policy of maintaining undervalued exchange rates.

Or is Korea the first to leave the dollar bloc? Given their scale of its exchange market intervention in the past two years the Bank of Korea's failure to intervene aggressively is a special source of wonder. The KRW has appreciated by 10% on a trade-weighted basis this year. It is even up 3% from September 2003, the month before the BoK/MoFE embarked on the short-lived very-weak KRW policy. It's stronger than at any time since late 2000. Some predict that the high costs of intervention eventually will lead individual Asian economies to abandon the policy of maintaining undervalued currencies. Korea may be the leading edge of this.

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LATEST RUMOR IN ASIAN CURRENCY DRAMA PLAUSIBLE EVEN IF DENIED

Chinese whispers frighten currency markets *FT*

The fragility in currency and bond markets has centred on fears that Asian central banks might dump US assets to avoid large losses as the dollar's value falls. The markets' nerves were highlighted by Friday's investor reaction to a report, later retracted, that China's central bank was offloading US Treasury bonds.

The data on this are pretty compelling. Over the last year, China's foreign reserves rose by $10.9 billion per month. According to Treasury data, Chinese investors have increased their holdings of US Treasuries by only $2.3 billion per month over the same period. Some minor factors explain some of the discrepancy (it's hard for Treasury to trace the actual owners of the bonds; the Chinese could also have been buying agency debt as part of their reserves). But two explanations probably compete for most of the discrepancy. The Chinese banking sector may be selling Treasuries (to finance demand for dollar-based loans) even as the government is buying them, and the government may be diversifying its foreign reserve holdings (but not "dumping" them), as the report on Friday suggested. We don't know how much each factor explains, but it would make sense for China to diversify before it announces anything, to minimize the disruptive effect of the move.

Is there evidence of this in declining OPEC purchases?

Chart 7: OPEC buying of US assets has diminished