

China Dumps dollar denominated Risk Assets

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Dollar-denominated risk assets, including asset-backed securities and corporates, are no longer wanted at the State Administration of Foreign Exchange (SAFE), nor at China's large commercial banks. The Chinese government has ordered its reserve managers to divest itself of riskier securities and hold only Treasuries and US agency debt with an implicit or explicit government guarantee. This already has been communicated to American securities dealers, according to market participants with direct knowledge of the events.

It is not clear whether China's motive is simple risk aversion in the wake of a sharp widening of corporate and mortgage spreads during the past two weeks, or whether there also is a political dimension. With the expected termination of the Federal Reserve's special facility to purchase mortgage-backed securities next month, some asset-backed spreads already have blown out, and the Chinese institutions may simply be trying to get out of the way of a widening. There is some speculation that China's action has to do with the recent deterioration of US-Chinese relations over arm sales to Taiwan and other issues. That would be an unusual action for the Chinese to take—Beijing does not mix investment and strategic policy—and would be hard to substantiate in any event.

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