United States Senate
Committee on Finance

Sen. Chuck Grassley · Iowa
Ranking Member

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M E M O R A N D U M

To: Reporters and Editors
Re: Chinese officials' comments on currency
Da: Wednesday, Aug. 8, 2007

Sen. Chuck Grassley, ranking member of the Committee on Finance, today expressed concern over comments from Chinese officials that China may liquidate its holding of U.S. treasuries if Congress tries to force a revaluation of the Chinese currency. Grassley made the following comment on his concern and wrote to the Chinese ambassador. The text of his letter follows.

"These types of threats are counterproductive and dangerous. They'll only harden people's views that China is purposely manipulating its currency to gain economic advantage. But they won't stop the United States from taking steps to encourage China to float its currency as a mature economic power. The Chinese government's leaders should clarify whether these comments are official government policy."

August 8, 2007

His Excellency Zhou Wenzhong
Ambassador of the People's Republic of China Embassy of the People's Republic of China 2300 Connecticut Avenue, N.W.
Washington, D.C. 20008

Dear Mr. Ambassador,

According to an article in today's edition of the Daily Telegraph, two Chinese government representatives have recently suggested that China may use its $1.3 trillion in currency reserves as a "bargaining chip" if the United States enacts new legislation to address undervalued foreign currencies. One of the individuals, an official at the Chinese Academy of Social Sciences, went so far as to suggest that China might be "forced" to take steps that would "lead to a mass depreciation of the dollar."

These types of dangerous comments illustrate why the United States is right to be concerned about China's currency practices. I would appreciate your confirmation that the comments do not reflect the official position of the Chinese government.

Sincerely,

Charles E. Grassley
Ranking Member

Here is the text of the Daily Telegraph article.

China threatens 'nuclear option' of dollar sales

By Ambrose Evans-Pritchard

Last Updated: 9:54am BST 08/08/2007

The Chinese government has begun a concerted campaign of economic threats against the United States, hinting that it may liquidate its vast holding of US treasuries if Washington imposes trade sanctions to force a yuan revaluation.

Two officials at leading Communist Party bodies have given interviews in recent days warning - for the first time - that Beijing may use its $1.33 trillion (£658bn) of foreign reserves as a political weapon to counter pressure from the US Congress.

Shifts in Chinese policy are often announced through key think tanks and academies.

Described as China's "nuclear option" in the state media, such action could trigger a dollar crash at a time when the US currency is already breaking down through historic support levels.

It would also cause a spike in US bond yields, hammering the US housing market and perhaps tipping the economy into recession. It is estimated that China holds over $900bn in a mix of US bonds.

Xia Bin, finance chief at the Development Research Centre (which has cabinet rank), kicked off what now appears to be government policy with a comment last week that Beijing's foreign reserves should be used as a "bargaining chip" in talks with the US.

"Of course, China doesn't want any undesirable phenomenon in the global financial order," he added.

He Fan, an official at the Chinese Academy of Social Sciences, went even further today, letting it be known that Beijing had the power to set off a dollar collapse if it choose to do so.

"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. Russia, Switzerland, and several other countries have reduced the their dollar holdings.

"China is unlikely to follow suit as long as the yuan's exchange rate is stable against the dollar. The Chinese central bank will be forced to sell dollars once the yuan appreciated dramatically, which might lead to a mass depreciation of the dollar," he told China Daily.

The threats play into the presidential electoral campaign of Hillary Clinton, who has called for restrictive legislation to prevent America being "held hostage to economic decicions being made in Beijing, Shanghai, or Tokyo".

She said foreign control over 44pc of the US national debt had left America acutely vulnerable.

Simon Derrick, a currency strategist at the Bank of New York Mellon, said the comments were a message to the US Senate as Capitol Hill prepares legislation for the Autumn session.

"The words are alarming and unambiguous. This carries a clear political threat and could have very serious consequences at a time when the credit markets are already afraid of contagion from the subprime troubles," he said.

A bill drafted by a group of US senators, and backed by the Senate Finance Committee, calls for trade tariffs against Chinese goods as retaliation for alleged currency manipulation.

The yuan has appreciated 9pc against the dollar over the last two years under a crawling peg but it has failed to halt the rise of China's trade surplus, which reached $26.9bn in June.

Henry Paulson, the US Tresury Secretary, said any such sanctions would undermine American authority and "could trigger a global cycle of protectionist legislation".

Mr Paulson is a China expert from his days as head of Goldman Sachs. He has opted for a softer form of diplomacy, but appeared to win few concession from Beijing on a unscheduled trip to China last week aimed at calming the waters.