

US Rates Watch

FAQs on central bank Treasury holdings

Bank of America
Merrill Lynch

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What do reserve managers own?

Of the almost \$16tn Treasuries outstanding, roughly \$4tn is held by international reserve managers. While individual countries do not disclose detailed information on their holdings, the Treasury department does publish a maturity breakdown on an annual basis for official investors as a whole (Chart 1, the latest published as of June 2018). The majority of reserve manager holdings are concentrated in the front end, but holdings do span across the curve. In addition, auction allotments seem to suggest new demand has been more concentrated in the intermediate sectors. For example, Q1 2018 and Q1 2019 both saw reserve manager buying (\$65bn and \$45bn, respectively), and auction takedowns in the long end have been reduced compared to a year ago (Chart 2).

In terms of product breakdown, based on TIC annual release, about \$400bn of the \$1.4tn TIPs outstanding are held by reserve managers. China makes up about half of the overall central bank TIPS holdings, or 15-20% of their entire UST holdings (Chart 3).

How has China's FX reserve management style changed?

The experience during 2015-2016 is still etched deeply in investors' minds, when China sold Treasuries to curb the pace of RMB depreciation. However, observations from FX markets and TIC data suggest the '15-'16 episode is water under the bridge (Chart 4):

- From Aug '15 to Dec '16, RMB saw about 10% depreciation vs USD, China sold about \$200bn USTs. However, a similar sized move from Apr '18 - Nov '18 saw just about \$50bn drop in their UST holdings.
- From Dec '16 - Aug '17, RMB appreciated by about 7% vs the USD (unchanged vs the basket), China bought roughly \$200bn USTs. More recently, a 5% rise in CNY vs USD from Sept '17 to Feb '18 saw about \$50bn increase in China's UST holdings.

We note that: 1) the data are based on TIC holdings, which have inherent custodial bias and are based on market value. This means it may not fully capture the actual changes of China's Treasury holdings. 2) Even if we capture China's true UST holdings, changes may happen due to FX reserve asset allocation rebalancing. Either way, we see the size of potential Treasury holding changes as much smaller than thought.

And why the change?

In our view, China is unlikely to materially change its Treasury holdings for two key fundamental reasons.

- First, since over 60% of PBoC's assets consist of FX reserves (Exhibit 1), changes in the size of China's FX reserve portfolio have direct impact on domestic money supply – the liability side of PBoC's balance sheet. A significant decline in PBoC's balance sheet would reduce domestic market liquidity and tighten financial conditions all else equal, something most central banks are trying to fight against.
- Second, the key source of FX reserve accumulation is current account surpluses. While China is still a major world exporter, the pace has slowed dramatically - its current account surplus dropping to almost zero in recent years from 10% of GDP in 2007 (Chart 5). From this perspective, it's also hard to see a fast ramp up in reserve assets.

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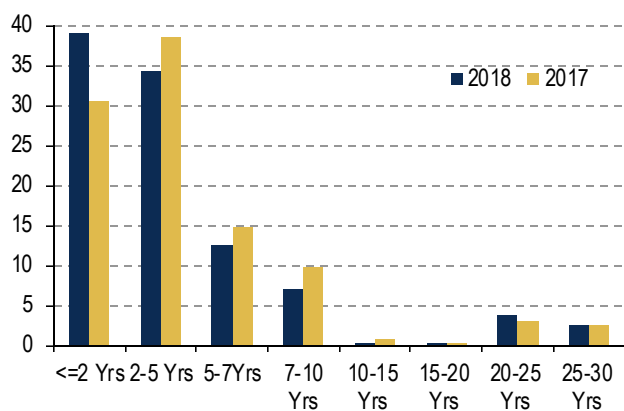
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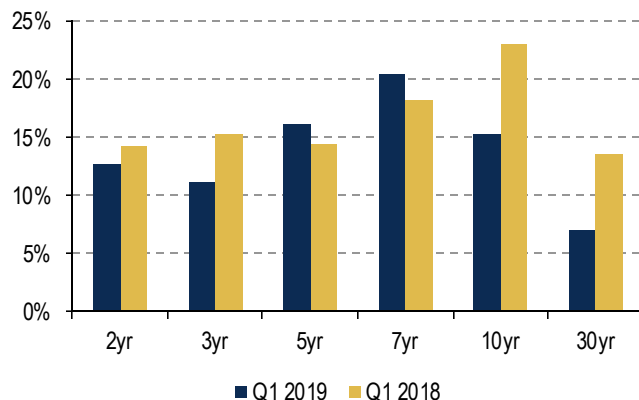
Chart 1: Reserve manager UST holdings span across the curve, with a concentration in the front end and the belly of the curve

% of foreign official holding by maturity bucket



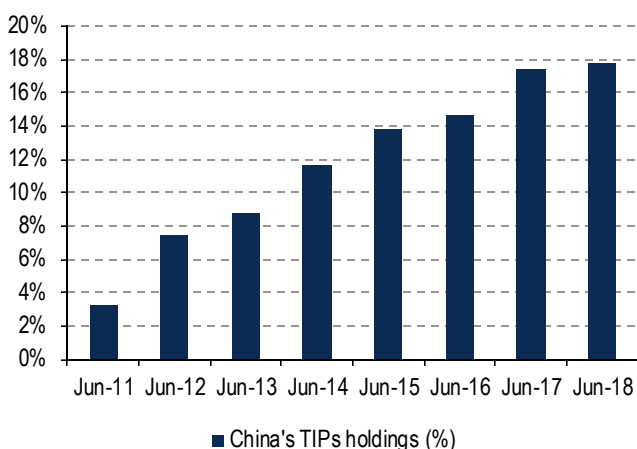
Source: BofA Merrill Lynch Global Research, TIC

Chart 2: Auction takedowns suggest foreign investors (official and private) have reduced long end appetite



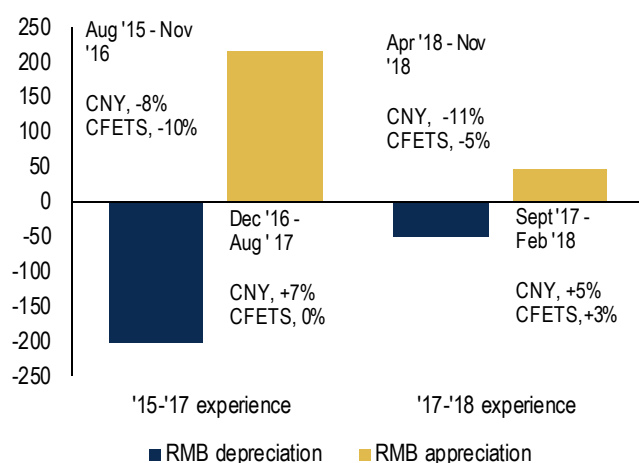
Source: BofA Merrill Lynch Global Research, Treasury Department

Chart 3: China's TIPS holdings have seen steady increase in recent years



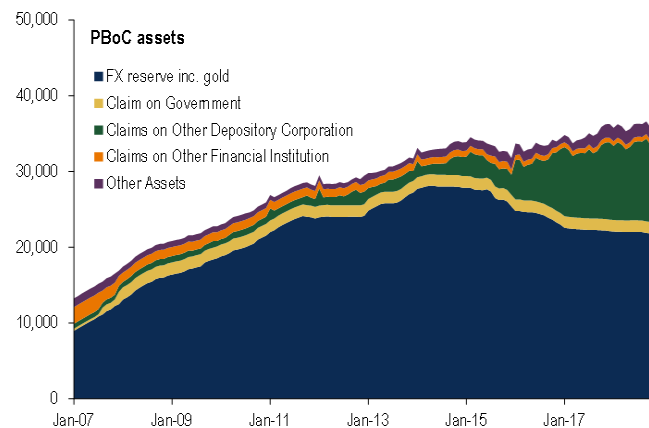
Source: BofA Merrill Lynch Global Research, TIC

Chart 4: Reserve manager reaction function to FX market has changed



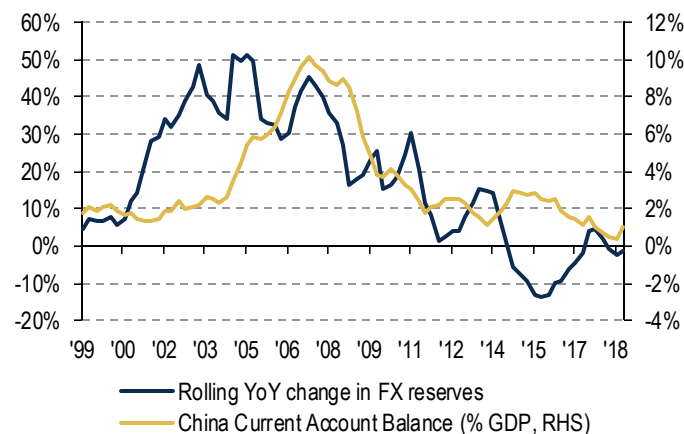
Source: BofA Merrill Lynch Global Research, Treasury Department

Exhibit 1: Over 60% of PBoC's balance sheet consists of FX reserves (¥bn)



Source: BofA Merrill Lynch Global Research, PBoC

Chart 5: FX reserve growth slowing down with C/A surplus slowing down



Source: BofA Merrill Lynch Global Research, Bloomberg

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