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Foreigners' Share of Treasurys Is Growing, Raising Some Fears

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WASHINGTON -- When the U.S. government borrows money these days, the chances are excellent that foreigners will be the ones writing the checks.

Foreign investors -- insurance companies, pension funds, central banks, individuals -- now own almost $1.3 trillion in U.S. government securities, 40% of Washington's $3.2 trillion in accumulated marketable debt, according to the latest federal statistics.

Five years ago, by contrast, foreigners held $641 billion in Treasurys, just 20% of the total at the time.

"Americans don't seem so interested in the Treasury market these days," says Bruce Steinberg, chief economist at Merrill Lynch & Co. But foreigners still are.

One Danger

Speeding that trend is the fact that the U.S. government is tapping budget surpluses to pay down the national mortgage, thus increasing foreigners' share of that debt. And that is raising concerns among some economists who fear that foreigners may be more inclined than domestic investors to pull their money out of U.S. markets at the first sign of trouble.

"We may be in for some difficult times ahead if the foreigners, especially governments, say, 'Why should we continue to hold securities in dollars?' " says Dimitri Papadimitriou, president of the Jerome Levy Economics Institute at Bard College in New York. "For the time being, one doesn't worry about it, but I don't think one should
be complacent about it." The result of a foreign pullout could be a sharp drop in the dollar and higher interest rates.

Still, in today's global market, it's far from clear that foreign investors are any more inclined to take their money out of the U.S. than American investors are. Indeed, Mr. Steinberg and many other analysts argue that foreign institutional investors behave more or less just like American pension funds and insurance companies.

The Japanese -- their own economy in the dumps for nearly a decade -- have been particularly enthusiastic about U.S. Treasurys recently. Europeans, once-avid Treasury buyers, have started taking bigger risks recently, plunging much more of their money into the U.S. stock market this year than last.

**Borrowing Abroad to Buy Imports**

This foreign investment wave is the flip side of the huge U.S. trade deficit, which hit a record $25.94 billion in October. The U.S., in essence, is borrowing abroad to buy imports and to invest at home. Foreigners finance that in many ways: They build factories in the U.S., snap up American companies, make deposits in American banks, roll the dice on U.S. stocks, purchase corporate bonds and buy U.S. government securities.

In the last five years, a growing number of foreign investors have chosen that last option. Treasurys are considered the safest place to invest, since virtually nobody takes seriously the risk of a U.S. default. That made them very attractive during the global financial crisis that started in Thailand in mid-1997 and came to a close earlier this year.

Central banks buy Treasurys as well, as they accumulate dollars. In recent months, the Bank of Japan, for instance, has been buying dollars in an effort to keep the yen from growing too strong. The
central bank doesn't want to leave that money in cash, and wouldn't risk it on the stock market, so it ends up buying dollar-denominated U.S. Treasurys.

"If you're in Japan and Japanese bonds pay 1.5% and Treasurys pay 6.5% -- or even if you're in Europe where [government bonds] pay 4% -- U.S. Treasurys look attractive, and corporate bonds look even more attractive," says Mr. Steinberg.

Foreigners' Natural Conservatism

Treasurys also appeal to the natural conservatism of some foreigners, especially Japanese insurance companies and other institutions. They want to put money in the U.S., but aren't confident in their ability to pick out individual companies on the stock or corporate-bond markets, says Takanobu Igarashi, chief economist at Sanwa Bank's New York office. "They're buying the U.S., not individual U.S. companies," says Mr. Igarashi. "That's why U.S. Treasurys are more popular among foreign investors than U.S. corporate bonds."

Of course, that appeal only lasts as long as the foreigners believe in the continued strength of the dollar. Should the dollar drop 6% against the yen, for instance, a 6% return from stocks or bonds would be wiped out for Japanese investors who measure their success one yen at a time.

While the dollar has lost ground against the yen in recent months, it has posted gains against the euro. Treasury Secretary Lawrence Summers has continued the strong-dollar rhetoric of his predecessor, Robert Rubin, and foreign investors apparently haven't lost confidence in the dollar yet. The Japanese plunked $37 billion down for U.S. bonds this year, even as they pulled $31 billion out of the stock market, according to Wrightson Associates, a New York bond-market research firm.

European investors, however, have begun to seek out higher returns than they can get from Treasurys. Europeans put 65% of their U.S. portfolio investments into stocks this year, up from 40% in 1998 and just 19% in 1997, Wrightson calculates.

Foreigners also purchased a record $69 billion in U.S. corporate and other non-Treasury bonds in the third quarter of this year, compared with $25.5 billion during the 1998 third quarter, according to the Commerce Department's Bureau of Economic Analysis.

Mr. Steinberg believes many foreigners' investment portfolios are too light on U.S. stocks, meaning they could well buy more shares in the months and years ahead.
Still, only 8.2% of U.S. stocks are in foreign hands, as of the third quarter of 1999, a mere fraction of foreigners' slice of the Treasury market.

Princeton economist Alan Blinder, former vice chairman of the Federal Reserve, says there is "an upside and a downside to borrowing money" from abroad. "The upside is you get your hands on the money. The downside is you have to pay it back."

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