

U.S. Treasuries: It's Foreign to Me

Published March 30, 2016

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When discussing trends in the U.S. Treasury securities market (UST), we often receive inquiries regarding foreign ownership. With that in mind, we thought it would be useful to provide an update on where things stood as calendar year 2016 got under way. Each month, the Treasury Department releases statistics on this front, but it should be noted that the actual data is provided with a one-month lag. Thus, the latest report, which was released on March 15, represented January 2016 data. The report itself is called Treasury International Capital Data—or “TIC,” as it is widely known in fixed income trading circles—and includes the figures for “Major Foreign Holders of Treasury Securities.” Before we go into the latest results, there is an important caveat. While the foreign holdings data does offer some useful insights, it is not without its flaws. Perhaps one of the more notable imperfections involves the safekeeping, or place of custody where the securities are held. The Treasury Department actually provides an example: if a German investor buys a U.S. security and places it in the custody of a Swiss bank, the holding is recorded for Switzerland, not Germany. According to the Treasury, this “custodial bias” leads to large holdings “in major financial centers, such as Belgium, the Caribbean banking centers, Luxembourg, Switzerland and the United Kingdom.” Total foreign holdings of Treasuries began the year on a solid upward trajectory and have now risen \$135 billion since October. Despite this most recent performance, on a year-over-year basis, total holdings are actually down \$35.6 billion, and prior to the aforementioned three-month period, the pattern had been more seesaw in nature. Needless to say, China tends to receive the lion’s share of the headlines, and rightfully so, as its UST holdings make up 20% of the total foreign tally, or \$1.24 trillion. Since last January, China’s total changed little, but the trend since August (when the yuan was devalued) has definitely been downward. To provide perspective, during this five-month timeframe, China’s UST holdings dropped \$32.6 billion, with \$26.6 billion coming off the books since November. Belgium has witnessed the largest decline over the last year, plunging \$217 billion. This development is of potential interest, because it is believed that China executes trades with Treasuries that are held in custody in Belgium. Taken together, it becomes apparent that China was using the dollar proceeds to counter the downward pressure its own currency had been experiencing. Some other notable developments have come from Japan, at 18% the second largest foreign holder of Treasuries, where holdings have plummeted \$115 billion over the last year. On the positive side of the ledger, Caribbean banking centers were up more than \$77 billion, while Switzerland, Luxembourg, Russia and the U.K. saw increases of \$31.9 billion, \$24.1 billion, \$14.7 billion and \$14.1 billion, respectively.

Conclusion What does all this mean for the broader UST market? Given the movement in UST yields at the beginning of the year, the answer seems pretty straightforward. Despite reported Chinese liquidations, other factors more than eclipse the “China” effect. From their post-Fed peaks in late December, the UST two-year yield has dropped more than 20 basis points (bps) while the five-year and ten-year yields are down over 40 bps each. The bottom line is that UST market trends in the months ahead will be predicated on the

factors investors have witnessed to date: the U.S./global economic backdrop, Fed policy considerations, favorable sovereign rate differentials and any potential safe-haven demand stemming from a negative headline event. ***Unless otherwise noted, source for data is U.S. Treasury Department, as of March 15, 2016.***

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