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U.S. Dollar Is `One Step Nearer' to Crisis as Debt Level Climbs, Yu Says

By Shamim Adam and David Yong - Sep 28, 2010

The U.S. dollar is "one step nearer" to a crisis as debt levels in the world's largest economy increase, said Yu Yongding, a former adviser to China's central bank.

Any appreciation of the dollar is "really temporary" and a devaluation of the currency is inevitable as U.S. debt rises, Yu said in a speech in Singapore today.

"Such a huge amount of debt is terrible," Yu said. "The situation will be worsening day by day. I think we are one step nearer to a U.S.-dollar crisis."

Yu also said China is worried about the safety of its foreign-exchange reserves including those invested in U.S. Treasuries as the U.S. currency weakens, reiterating his earlier views on the dollar assets. The U.S. will record a $1.3 trillion budget deficit for the fiscal year ending Sept. 30, the Congressional Budget Office said Aug. 19.

The estimated budget deficit for this fiscal year would be equivalent to 9.1 percent of gross domestic product, the CBO said. That would make it the second-largest shortfall in 65 years, exceeded only by the 9.9 percent in 2009.

The CBO also projected the U.S. would have a cumulative deficit of $6.27 trillion in the next decade, higher than its March estimate of $5.99 trillion.

Reduced U.S. Holdings

China, the biggest foreign investor in U.S. government bonds, cut its holdings by about 10 percent to $846.7 billion in the 12 months ended July, according to the Treasury Department.

U.S. Treasuries fail to provide safety or liquidity in managing China's $2.45 trillion foreign-exchange reserves, Yu said in an e-mail in August. To help cool demand for the securities, China needs to curb the growth of its foreign reserves by intervening less in the currency market, he said.

China should reduce its holdings of U.S.-dollar assets to diversify risks of "sharp depreciation," Yu said in July. The nation should convert some holdings in U.S. dollars into assets denominated in other currencies, commodities and direct investments overseas, he wrote in a commentary in the China Securities Journal.

The increased convertibility of the yuan will ease pressure on the currency to appreciate, Yu said today at an event organized by Singapore Management University.

The yuan has strengthened almost 2 percent against the dollar since June 19, when China's central bank said it will pursue a more flexible exchange rate. China maintained a peg of 6.83 yuan per dollar from July 2008 to June 2010.

Yuan Level

China will independently determine the level of the yuan and the U.S. doesn't need to vote on the issue this week, Vice Commerce Minister Chen Jian said in Taipei yesterday.

The U.S. House of Representatives is due to vote tomorrow on legislation pressing China to raise the currency's value amid assertions the yuan is undervalued and gives the Asian nation a trade advantage. The legislation would let companies petition for higher duties on Chinese imports.

"The basic trend is for an appreciation" of the yuan, Yu said in an interview after his speech today. "No one can predict the specific pace of the appreciation. This is difficult to say as it depends on circumstances. We should not be speculators."

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