



Federal Financial Analytics, Inc.

**SHARP SPIKE IN CHINA AGENCY BOND HOLDINGS DRIVES US GSE  
POLICY, FEDFIN ANALYSIS FINDS**

“China has ... a fragile, stressed banking system that could not withstand even a short-term liquidity crunch from any GSE market shock.”

FOR IMMEDIATE RELEASE – August 12, 2005  
CONTACT: Chris Young (202)296-5240

WASHINGTON, D.C. – A report released by Federal Financial Analytics (FedFin) estimates that China holds as much as 25% of the agency bonds in foreign hands. This, FedFin concludes, makes clear that problems in China’s banking system would have systemic impact and explains in part the push by the Bush Administration and Federal Reserve to reign in Fannie Mae and Freddie Mac portfolios.

“The Treasury data show that China’s GSE bond holdings are now over \$144 billion and match their holdings of US Treasury bonds,” said Basil N. Petrou, FedFin managing partner. “This is double what it was three years ago and means that China’s fragile banking system is extremely vulnerable to any shocks in the GSE debt market. Of course, these big holdings also mean the U.S. financial system is more vulnerable to any China shock. While policy makers have talked about the systemic risk to the U.S. financial

markets from a GSE debt crisis, it appears to us that the more immediate systemic-risk fears come from China's holdings of GSE debt," Petrou continued.

FedFin draws its conclusions from data on China released for the first time in conjunction with the Treasury's most recent quarterly debt refunding. It shows that, in recent years, China's holdings of GSE bonds has grown faster than its holdings of Treasury bonds.

Now, almost equal amounts are held of each. The \$150 billion of Treasury bonds held by China is reported by Treasury as 12% of all foreign holdings of Treasury securities.

FedFin, as noted, calculates the \$144.5 billion of GSE bonds held by China as about 25% of total offshore holdings of GSE bonds, showing that China has taken a highly-

concentrated stake in Fannie Mae, Freddie Mac and the Federal Home Loan Banks. This is doubtless because of the agency paper's implicit federal guarantee – precisely the risk frequently noted in Administration and Federal Reserve testimony to Congress, the FedFin report states.

Copies of the report are available by request via return e-mail or telephone Arezou Rafikian at 202-296-5240.

*Federal Financial Analytics, Inc. has for the past eighteen years counseled large financial institutions and even their regulators on major legislative, regulatory and policy issues that pose strategic risk. It does not lobby on behalf of clients, but advises them on appropriate responses in light of identified challenges, working on an array of GSE, Basel II, and acquisition-value issues. The firm publishes numerous information and analytical services, including Financial Services Management and GSE Activity Report.*

#####