

Asia watches and hopes US will avoid debt 'suicide'
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SINGAPORE, July 25 — Bewildered Asian officials could only watch and hope for the best today after US lawmakers failed to break a debt impasse that threatens to trigger a default and up-end global financial markets.

Asia, which owns nearly one-third of the publicly-held US government debt, has a powerful vested interest in Washington solving its debt troubles.

Policymakers and economists contacted by Reuters were confident that lawmakers would strike a last-minute deal to avert a crisis.

But with just eight days left before August 2, when the Treasury Department has estimated it will run short of money to pay all of its bills, the worry level was rising.

"Those in direct charge of reserves operations must be more nervous than before, but nobody thinks Americans will choose suicide when they have known solutions," said a senior official at the Bank of Korea, who spoke on condition of anonymity because he was not authorised to speak to the news media.



Japanese Finance Minister Yoshihiko Noda (**picture**), when asked about the breakdown in the US debt talks, said only: "I will be watching the situation."

Investors in Asia took a defensive stance, although there was no evidence of the sort of panic selling that some lawmakers in Washington had feared. Stocks slipped while the Swiss franc rose and gold hit a record high.

Asian sources said the US debt troubles were primarily political, not economic. Finding a solution was a matter of mustering political will rather than securing rescue funding, which can be far more complicated, as Greece's recent difficulties showed.

Congress has set the US government's borrowing limit at US\$14.3 trillion (RM42.9 trillion), but Treasury has already tapped that amount and needs more money to meet

its obligations. Republicans want an agreement on spending cuts before they authorise more borrowing. Democrats want to see a mix of lower spending and higher taxes.

Ratings agencies have warned that even if Congress raises the debt ceiling and averts a default, they may still strip the United States of its coveted AAA credit rating, the highest possible, if lawmakers fail to agree on deeper long-term budget cuts.

A lower credit rating could raise borrowing costs not only for the US government but for other countries, companies and consumers because US Treasuries are the benchmark by which other loans are measured.

Ethan Harris, co-head of global economic research at Bank of America-Merrill Lynch, said he expected a temporary increase in the debt ceiling with the promise of up to US\$4 trillion in deficit reductions to be finalised six months later.

"The base case scenario can be summarised as 'appease and delay' — appease the rating agencies and the market with the beginnings of a large plan, but in actuality delay the crisis further into the future," Harris said.

Robert Tipp, chief investment strategist at Prudential Fixed Income in Newark, New Jersey, said the US Treasury may have a bit of wiggle room on the August 2 deadline because tax revenues had exceeded expectations. But that would buy a few days, not weeks.

For Asian policymakers, there is no alternative to investing in US Treasuries. China and Japan are by far the world's biggest foreign owners with more than US\$2 trillion in Treasuries combined, and no other market in the world is deep enough to absorb that size of investment.

Taiwan, Thailand, Singapore, India and South Korea all rank among the major holders of US debt as well, a legacy of the Asian debt crises of the late 1990s.

Many countries in the region have built up vast reserves as a form of self-insurance so that they would never again have to go hat-in-hand to the International Monetary Fund.

Indeed, Asia's healthy public finances have made the region attractive to global investors who shunned it as far too risky just 10 years ago.

Mark Mobius, executive chairman of Templeton Asset Management's emerging markets group, said more money might flow into Asian currencies and bonds if US debt talks fail.

"People will see that as a safer alternative," said Mobius, whose group manages US\$50 billion. "You are already beginning to see that trend. Some of the emerging countries have a lower cost on credit default swaps (than) the developed countries."

Japan's yen has been a big beneficiary of global worries about both US and European sovereign debt sustainability, and Tokyo has expressed concern that the strengthening yen will hurt its exporters.

Noda, the finance minister, said he was watching foreign exchange markets "carefully."
— Reuters

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