US caught China buying more debt than disclosed

REUTERS, *New York*

The rules of Treasury auctions may not sound like the stuff of high-stakes diplomacy. But a little-noticed 2009 change in how Washington sells its debt sheds new light on America's delicate balancing act with its biggest creditor, China.

When the Treasury Department revamped its rules for participating in government bond auctions two years ago, officials said they were simply modernising outdated procedures.

The real reason for the change, a Reuters investigation has found, was more serious: The Treasury had concluded that China was buying much more in US government debt than was being disclosed, potentially in violation of auction rules, and it wanted to bring those purchases into the open - all without ruffling feathers in Beijing.

Treasury officials then worked to keep the reason for the auction-rule change quiet, with the acting assistant Treasury secretary for financial markets instructing subordinates to not mention any specific creditor's role in the matter, according to an email seen by Reuters. Inquiries made at the time by the main trade organisation for Treasury dealers elicited the explanation that the change was a "technical modernisation," according to a document seen by Reuters. There was no mention of China.

The incident calls into question just how clear a handle the Treasury has had on who is buying US debt. Chinese entities hold at least $1.115 trillion in US government debt, and are thought to account for roughly 26 percent of the paper issued by Washington, according to US government data released on June 15.

China's vast Treasury holdings are both a lifeline and a vulnerability for Washington - if the Chinese sold their

Treasuries all at once, it could undermine US markets and the economy by driving interest rates higher very quickly. Scenarios of this sort have been discussed in Washington defence-policy circles for at least a year now. Not knowing the full extent of these holdings would make it even more difficult to assess China's political leverage over US finances.

The Treasury has long said that it has a diversified base of investors and isn't overly reliant on any single buyer to digest new US Treasury issuance. Evidence that China was actually buying more than disclosed would cast doubt on those assurances.

The United States sells its debt to investors through auctions that are held weekly - sometimes four times per week -- by the Treasury's Bureau of the Public Debt, in batches ranging from $13 billion to $35 billion at a time. Investors can buy the bonds directly from the Treasury at auctions, or through any of the 20 elite "primary dealers," Wall Street firms authorized to bid on behalf of customers. The Treasury limits the amount any single bidder can purchase to 35 percent of a given auction. Anyone who bought more than 35 percent of a particular batch of Treasury securities at a single auction would have a controlling stake in that batch.

By the beginning of 2009, China, which uses multiple firms to buy US Treasuries, was regularly doing deals that had the effect of hiding billions of dollars of purchases in each auction, according to interviews with traders at primary dealers and documents viewed by Reuters.

Using a method of purchases known as "guaranteed bidding," China was forging gentleman's agreements with primary dealers to purchase a certain amount of Treasury securities on offer at an auction without being reported as bidders in that auction, according to the people interviewed. After setting the amount of Treasuries the guaranteed bidder wanted to buy, the dealer would then buy that amount in the auction, technically on its own behalf.

To the government officials observing the auction, it would look like the dealer was buying the securities with the intent of adding them to its own balance sheet. This technicality does not preclude selling them later in the secondary market, but does influence the outcome of bidding in the auction, by obscuring the ultimate buyer. In fact, the dealer would simply pass the bonds on immediately to the anonymous, guaranteed bidder at the auction price, as soon as they were issued, according to the people interviewed.

The practice kept the true size of China's holdings hidden from US view, according to Treasury dealers interviewed, and may have allowed China at times to buy controlling stakes - more than 35 percent - in some of the securities the Treasury issued.

The Treasury department, too, came to believe that China was breaching the 35 percent limit, according to internal documents viewed by Reuters, though the documents do not indicate whether the Treasury was able to verify definitively that this occurred.

Guaranteed bidding wasn't illegal, but breaking the 35 percent limit would be. The Uniform Offering Circular -- a document governing Treasury auctions -- says anyone who wins more than 35 percent of a single auction will have his purchase reduced to the 35 percent limit. Those caught breaking auction rules can be barred from future auctions, and may be referred to the Securities and Exchange Commission or the Justice Department.

The Treasury Department generally does not comment on specific investors but a source in the department said China was not the only Treasury buyer striking guaranteed bidding deals.

TO BE CONTINUED

Fuel inflation accelerates to 8-week high in India

REUTERS, *New Delhi*

India's fuel price inflation hit an eight-week high in mid-June, showing price pressures persisted even before the government's recent increase in diesel prices and suggesting headline inflation in Asia's third-largest economy is headed towards double-digits again.

While food inflation eased to a six-week low of 7.78 percent in the week to June 18, from 9.13 percent a week earlier, the fuel price increase and its knock-on effects are expected to add to the case for continued tightening of monetary policy.

The fuel price index climbed 12.98 percent in the week to June 18, before the fuel price rise took effect, from 12.84 percent a week earlier, government data showed on Thursday.

New Delhi raised prices of diesel, cooking gas and kerosene last Friday, a politically unpopular move that adds to inflationary pressure, but gives relief to oil companies reeling from revenue losses on state-set fuel prices amid high global crude prices.

"Last week's fuel prices hike will have first and second round impact on overall inflation, which will start getting reflected in the data next week onwards," said Aditi Nayar, an economist with ICRA.

Standard Chartered expects the increase in diesel and other fuel prices, which was effective June 25, to add about 70 basis points to headline inflation.

The headline wholesale price index (WPI) inflation stood at an annual 9.06 percent in May despite continued monetary policy tightening by the Reserve Bank of India (RBI), which has increased interest rates 10 times since March 2010.

The RBI is widely expected to raise rates by another 50 basis points in coming months, which could further erode demand in an economy that grew at 7.8 percent in January-March, its slowest in five quarters.

Food prices, which are volatile and have been a key driver of inflation in India for nearly two years, are driven heavily by the summer monsoon, which began earlier this month.

"The real outlook on food will emerge only after July 10. The last 10 days of June and first 10 days of July are a crucial period for the monsoon," said Sujan Hajra, chief economist at Anand Rathi Financial Services in Mumbai.

"Once we get the data on that, one can take an informed view on the food prices. But as of now, food inflation should remain in single digits," he said.

Diesel, cooking gas and kerosene comprise 6.4 percent of the total WPI basket and 70 percent of the fuel component of the WPI. The primary articles price index was up 11.84 percent, compared with an annual rise of

Germany slams proposed EU budget

AFP, *Berlin*

Germany on Thursday blasted as "irresponsibly high" the European Commission's proposal for the next 2014-2020 budget, saying it set a poor example during the eurozone debt crisis.

"My first impression from the proposals presented... is that the Commission's total volume of the budgetary framework is, for the German government, irresponsibly high," Foreign Minister Guido Westerwelle said in a statement.

"In times of general budgetary consolidation Brussels must also send a message to frugally and sustainably economise."

He said the European Union, like debt-wracked members of the eurozone, needed to sharply limit spending.

Westerwelle said Germany saw one percent of EU economic output -- forecast as one trillion euros ($1.4 billion) for the 2014-2020 period -- as sufficient to cover EU spending during that time.

He also blasted the Commission's calls for the introduction of an EU sales tax and financial services tax, saying a majority of EU states opposed such a move.

"We don't need such taxes because the EU does not have a financing problem," the minister, a member of the pro-business Free Democrats, said.

He said he welcomed new provisions for research, education and innovation and called on the EU to invest an even greater share of its budget in these areas by shifting funds from other, unspecified expenditures.

The European Commission urged the introduction of an EU sales tax and financial services tax as part of an overhaul of the next EU budget.

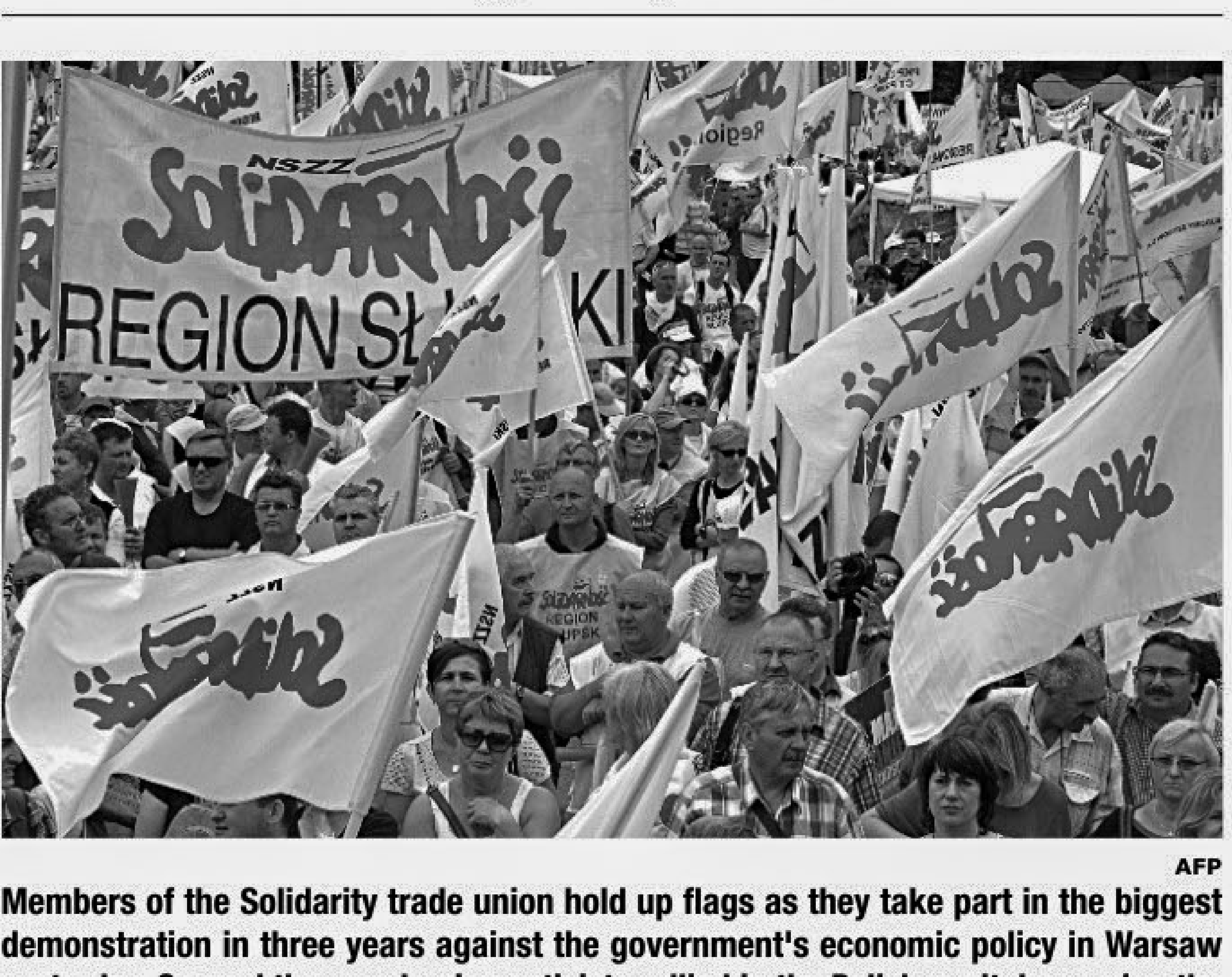
The proposals from Commission president Jose Manuel Barroso to seek new sources of revenue aim to allow the bloc's executive arm to raise its own funds rather than depend so heavily on funding from the EU member states.

The outline of the next seven-year budget totalled 1.025 trillion euros in commitments or about 1.05 percent of output.

Britain also slammed the proposals as "unrealistic".

Germany, the biggest economic power in the EU, is the top contributor to the the 27-member bloc's budget with payments of 20 billion euros per year.

Subtracting what it receives from the EU budget, its net annual contribution is eight billion euros.



AFP

Members of the Solidarity trade union hold up flags as they take part in the biggest demonstration in three years against the government's economic policy in Warsaw yesterday. Several thousand union activists rallied in the Polish capital accusing the centre-right government of sidelining social and economic problems, as Poland braces to take the helm of the EU. Solidarity is best known internationally for having helped bring down Poland's communist regime in 1989.

Lloyds bank axes 15,000 jobs

AFP, *London*

Britain's state-rescued Lloyds bank said Thursday it will axe 15,000 jobs in a drastic cost-cutting plan that will halve its international base and save £1.5 billion (1.66 billion euros, $2.4 billion) per year by 2014.

LBG will "simplify the group to improve service and deliver £1.5 billion of annual savings in 2014" via measures that will include a "reduction of 15,000 roles", the company said in a statement issued after a strategic review.

The major overhaul, carried out under the leadership of new chief executive Antonio Horta-Osorio, will seek to "streamline our international presence, from 30 countries to less than half that number by 2014", it added.

The loss-making group, which is 41-percent state-owned after a huge bailout at the height of the global financial crisis, has now slashed more than 40,000 jobs since 2009 as it looks to guide its way back to health.

The majority of the job losses will be in middle management and back-office roles, such as IT and support functions, and also in its international operations.

Lloyds stressed it would seek to shed staff through natural attrition and redeployment rather than redundancy. The job cuts amount to approximately 14 percent of the group's current workforce of about 106,000 people.

"It's important to note that these are roles not people. We have a strong record of minimising redundancies," said Horta-Osorio.

"We have to do this. This bank has lost money, it's losing money this year on

British public sector workers strike in pensions row

AFP, *London*

Hundreds of thousands of British public sector workers went on strike Thursday to defend their pensions, causing widespread school closures in a major challenge to the year-old government.

Jobcentres, tax offices and museums were also closed across the country as four unions called out up to 600,000 workers to protest against plans to make them work longer and pay more into their pensions.

However, airport operator BAA said fears of delays at London Heathrow from a walkout by immigration and customs staff had failed to materialise on Thursday morning.

Prime Minister David Cameron said the strike was premature as the changes were still being negotiated, and warned that with an ageing population reform was inevitable because "the pension system is in danger of going broke".

Action by three education unions caused the closure of about a third of schools in England and the disruption of another third, according to the Department for Education. There was also widespread disruption in Wales.

Picket lines were also set up outside government buildings, law courts and even the British Museum, and several thousand people gathered for a march in London, brandishing banners calling for "Fair pensions for all".

"I will lose £60,000 (66,000 euros, $96,000), I'll pay an extra £60 a month and I'll have to work seven or eight years longer" under the reforms, said Richard Jones, a 39-year-old civil servant on the march.

It looks set to be the largest public sector strike since one million local government workers walked out in March 2006, and some union leaders have warned it may only be the beginning of months of industrial unrest over pensions.

Cameron's Conservative-Liberal Democrat coalition has been the focal point of public sector anger after it announced a two-year pay freeze and 330,000 job losses by 2015 in an attempt to rein in a record budget deficit.

AFP

A member of the Public and Commercial Services union pickets outside New Scotland Yard in London yesterday.

It is now facing the possibility of widespread unrest just 13 months after it took office over plans to delay the retirement age for public sector workers by up to six years, increase their contributions and replace their final salary pensions with ones based on their average career earnings.

"This is the best-supported strike we've ever had," said Mark Serwotka, the head of the Public and Commercial Services (PCS) union, which has called out 250,000 civil servants for the strike.

He said they were sending "a clear message to the government that they will not tolerate these attacks on their hard-earned pensions rights".

The biggest impact appeared to be on schools as members of the National Union of Teachers (NUT) and the Association of Teachers and Lecturers (ATL) walked out. Staff in the University and College Union (UCU) also joined them.

Education minister Michael Gove said he was "disappointed" at the action.

Ministers say the strike is premature given that talks on the reforms were ongoing, and note that Unison, the biggest public sector union with 1.3 million members, had opted to keep talking, although it may strike later this year.

Francis Maude, the minister who oversees the civil service, told BBC radio: "You cannot continue to have more and more people in retirement being supported by fewer and fewer people in work. Long-term reform is needed."

However, the unions say they have already accepted reforms over the past decade but say the government is trying to push through the new changes without any offer of compromise.

Ed Miliband, the leader of the main opposition Labour party which has historically close ties to the trade union movement, urged both sides to return to the negotiating table.

"These strikes are wrong at a time when negotiations are still going on but parents and the public have been let down by both sides because the government has acted in a reckless and provocative manner," he said.