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Foreign Interest Appears to Flag as Dollar Falls

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WASHINGTON, Nov. 26 - Investors and market analysts are increasingly worried that the last big source of support for the American dollar - heavy buying by foreign central banks - is fading.

The anxiety was on full display Friday, when the dollar abruptly slid to a record low against the euro after a report suggesting that the Chinese central bank might start to reduce its holdings in the American currency.

Though Chinese officials later denied the report, and the dollar recovered, analysts say the broader trend is that foreign governments are becoming less willing to finance the growing debt of the United States government.

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On Tuesday, a top official with the Russian central bank said his government had become worried about the sinking value of the dollar and might switch some foreign reserves to euros.

A day later, India's central bank hinted that it was worried about the same issue and might shift some reserves into other currencies.

Japan and China, which together have amassed nearly \$900 billion in United States Treasury securities, have both slowed their buying sharply from the frenetic pace in February and March.

"There is an emerging consensus that banks around the world are moving to expand their reserves of euros at the expense of dollars," said Laidi Ashraf, chief currency analyst at MG Financial Group in New York.

The Bush administration has essentially condoned the dollar's decline. At meetings with foreign ministers last week, the Treasury secretary, John W. Snow, repeated the American mantra of support for a "strong dollar" but also for letting "market forces" determine exchange rates.

A continued decline of the dollar would be good for American manufacturers, because it would make exports cheaper in foreign markets and push up the cost of imports.

But a diminished foreign appetite for dollars could push up interest rates. The Federal Reserve has already raised short-term rates four times this year, but the shift in the sentiment of foreign investors may soon seriously affect long-term rates that


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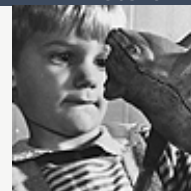


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influence the cost of home mortgages.

"Sell U.S., buy Europe," summed up Richard Berner, chief United States economist at [Morgan Stanley](#), in a report last week. Mr. Berner noted that investors have begun demanding higher yields for 10-year Treasury securities than for comparable European bonds, and he predicted that the spread would widen.

Recent data from the Treasury Department indicated that foreign governments had sharply slowed their purchases of Treasury securities. The question is whether those purchases will continue to slow or start to increase again as countries try to shore up the American currency to help maintain their own industries' competitiveness.

Japanese purchases of Treasury securities, which ballooned by about \$100 billion from October 2003 to March of this year, have slowed sharply and actually declined slightly in September.

Largely as a result, the dollar has sunk to its lowest level against the Japanese yen, about 102.5 yen to the dollar on Friday, in four and a half years.

Chinese purchases of Treasury securities slowed to a crawl, increasing just \$2 billion in September, to \$174 billion.

On Friday, a top Chinese central bank official denied reports in a Chinese newspaper that the government planned to reduce its holdings of Treasury bonds.

But Chinese officials, under prodding from the Bush administration, have repeatedly said they want to gradually relax their 10-year-old policy of locking its currency, the yuan, at a fixed exchange rate to the dollar. Any move to a more flexible exchange rate for China would probably cause the dollar to drop in value and allow the Chinese central bank to stop buying United States debt securities.

America's current account deficit, the broadest measure of its indebtedness to other countries, is on track to exceed \$600 billion next year, about 6 percent of its gross domestic product. The United States needs to attract about \$2 billion a day to keep its spending at current levels.

The nation attracted enormous sums of foreign money in the late 1990's as well, but the character of that money has changed. Back then, a big part of the inflow was through foreign direct investment and purchases of American stocks.

This year, by contrast, foreigners have been net sellers of stocks. The big growth has been in foreign purchases of Treasury securities, and the big buyers have been foreign central banks that wanted to prevent their own currencies from rising too much against the dollar.

Tony Norfield, currency strategist for [ABN Amro](#) in London, said he was convinced that central banks were trying to scale back their purchase of dollar assets, a move that could push the euro, already up about 30 percent in the last years, even higher.

"You do not need the central banks to sell Treasuries for the dollar to go down," Mr. Norfield said. "All they have to do is buy less and the dollar is going to be in trouble."

The euro hit a new high of \$1.3329 on Friday in light trading, before settling back about a half-penny.

European leaders are alarmed about the potential damage of a sinking dollar to their exports.

"Recent moves on exchange markets of the dollar versus the euro are unwelcome," said Jean-Claude Trichet, president of the European Central Bank, at a banking seminar on Friday in Rio de Janeiro.

"I want to underline the importance of recent statements by the Treasury secretary of the United States on his determination to pursue a strong dollar policy," Mr. Trichet added.

But Mr. Snow and Alan Greenspan, the chairman of the Federal Reserve, offered no hint that they would intervene in currency markets to prop up the dollar.

"The market for U.S. Treasury securities is deep and liquid and continues to be attractive to a broad and diverse pool of investors," a spokesman for Mr. Snow, Robert Nichols, said.

That remains to be seen. According to the most recent Treasury data, the biggest source of growth in securities came not from China, Japan or Europe but from Caribbean banking centers.

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