RELEASE IN PART B6

From: Sullivan, Jacob J <SullivanJJ@state.gov>
Sent: Friday, August 31, 2012 1:03 PM
To: H
Subject: Fw: NYT Blog - Fear-of-China Syndrome

This is interesting.

From: Nuland, Victoria J
Sent: Friday, August 31, 2012 01:07 AM
To: Sullivan, Jacob J
Subject: Fw: NYT Blog - Fear-of-China Syndrome

From: PA Clips [mailto:paclips@state.gov]
Sent: Thursday, August 30, 2012 06:09 PM
To: PA-Monitoring-Group-DL
Subject: NYT Blog - Fear-of-China Syndrome

Fear-of-China Syndrome
New York Times Blog
August 30, 2012, 5:18 pm
Paul Krugman

Ah. Let's give thanks to Rob Portman, who offered a nice break from all the lies in Tampa, and instead offered us some good old-fashioned bad macroeconomics.

In his speech, Portman castigated the Obama administration for not taking a tougher line on China — which is actually something I've complained about too — then offered a completely wrong explanation. Obama won't take on China, Portman said, because

Obama could not run up his record trillion dollar deficits if the Chinese did not buy our bonds to finance them

OK, let's ask the question: how much overseas financing does the United States as a whole need?

The answer is that it's determined by an accounting identity: capital inflows = the current account deficit, a broad measure of the trade balance including income on investments. (Trade can adjust to capital flows instead of the other way around, but that's a longer story).

So what has happened to the current account deficit as a share of GDP in the Obama era? Um, it's way down:

(I multiplied by 400 because the current account data are quarterly, while GDP is stated at an annual rate)

How is it possible that we're borrowing much less from foreigners when the government deficit has gone up so much? The answer is that the private sector is deleveraging, having moved into massive surplus as consumers try to pay down debt and corporations hold back on investment in the face of weak consumer demand. All those government deficits have only partly offset this move, so that overall national borrowing from overseas is down, not up.

But what would happen if the private sector stopped deleveraging? The answer is, we'd have a strong economic recovery, which would among other things greatly reduce the budget deficit. A side implication of this point, of course, is that for the time being that deficit is a good thing, helping to support the economy while the private sector unwinds its excessive leverage.

So who's actually financing the US budget deficit? The US private sector. We don't need Chinese bond purchases, and if anything we're the ones with the power, since we don't need their money and they have a lot to lose. In fact, we don't want them to buy our bonds; better to have a weaker dollar (a point that the Japanese actually get.)

To make excuses for Portman, lots of people keep getting this wrong, even after all these years. But really, truly, the last thing we need to worry about is whether the Chinese love our bonds.

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