

Contributors

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Chart 1

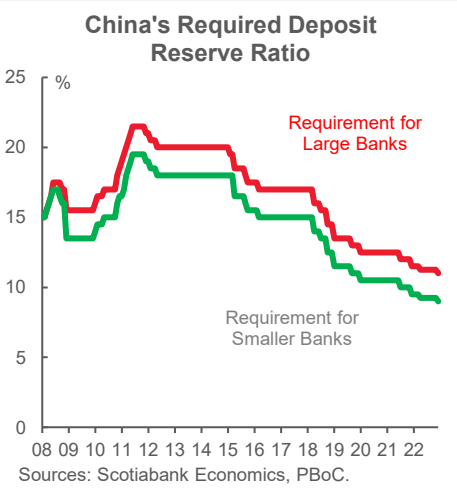


Chart 2



Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
No Scheduled Indicators or Events.							

KEY POINTS:

- Dollar strengthens, yields spike amid light volumes
- Yuan weakens on China's RRR cut...
- ...that otherwise had little effect as it was well anticipated
- Why the PBoC cut the required reserve ratios...
- ...and why it will probably have little to no net effect
- Apple's anecdote speaks volumes on this being early days for supply chain upheavals
- US markets face early close

A quiet session has been spiced up a bit by China's well telegraphed decision to cut its required reserve ratios this morning. That's carrying little to no incremental effect on markets in part because it's not a surprise and partly because there were more negative headlines out of China overnight concerning case counts and stealth restrictions. The half day—if that—in US markets will impair global volumes as bonds shut at 2pmET and stocks close at 1pmET.

Sovereign bonds have a cheapening bias this morning with EGBs underperforming a sell-off in US Treasuries across the curve. The USD is firmer and especially versus the yen and yuan. Stocks are little changed with a slightly negative bias across N.A. futures and European cash. Asian equities slipped a touch in Tokyo, Seoul, HK and Shenzhen with the Shanghai Composite bucking the trend somewhat. Oil is up by over a buck across the benchmarks.

The PBoC cut required reserve ratios by 25bps effective two Mondays from now. A cut has long been anticipated even well before the State Council intimated the other day that it would pursue such a measure. See chart 1.

The PBoC estimates that the measure will inject about US\$70B of liquidity into the system which is modest to say the least.

So why do it? The main motive is to address liquidity strains. Measures of liquidity had been deteriorating over time while downside risks to the economy have been intensifying. China's one-year interest rate swap has risen by about one-third of a percentage point since mid-August (chart 2). The one-year volumes in the Medium-Term Lending Facilities have recently soared amid concern toward how a large maturity in mid-November would be handled.

A related motive is to spur lending activity, or to at least prevent further weakening due to liquidity strains. Growth in the stock of outstanding yuan-denominated loans has been steadily decelerating since the earliest days of the pandemic (chart 3).

The cuts extend years of reductions dating back to 2011 as the required reserve ratios have been roughly halved over this time. At the same time, the Tier One risk-based capital ratio of Chinese banks has modestly risen by about a percentage point to 12.2% now. By contrast, the same ratio for US banks now sits at 13.6 and has increased by about 2½ ppts over the same period (chart 4).

So will it work? I'm doubtful. First, it's not really incremental stimulus if all it is designed to do is to free up liquidity that has been under strain. The move just seeks to offset some of

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that and try to prevent further worsening. Second, amid mounting downside risks to China's economy, using various monetary policy tools to try to encourage more lending requires willing lenders—which is perhaps less of the problem in a system where the state has the power to tell many of the banks what to do—and willing borrowers. It's the latter that I doubt will respond as monopolies face the pushing-on-a-string critique. Third, the PBoC's ability to follow through with other easing measures remains constrained by the implications for the yuan on the Fed-PBoC policy differentials.

On a mildly related note, apparently if you have an eye on putting an Apple iPhone 14 pro or pro max phone under the Christmas tree this year then you're out of luck as the deliveries are now being pushed out to January 3rd and hence after Christmas. Analysts are pointing to the doubling of wait times over the past month due to the issues at "iPhone City" in China. I mention this because the macro implications fit my narrative that we remain at a highly nascent stage of revamping global supply chains.

On that note, everyone is focused upon short-term progress toward healing global supply chains that not only may face renewed setbacks but also face years of turmoil ahead. The macro thesis that remains intact is that while there are countless articles about near-term inflation and inventories and like matters, it remains very early days for c-suites that are grappling with how to adjust their supply chains to a permanently changed world.

The 2016 US election and Brexit vote started it all by injecting uncertainty into global trade arrangements (looking at you, Trump and Boris). The pandemic and Ukraine war escalated the disruptions to an altogether different level. Years of outsourcing to the lowest cost jurisdictions over the preceding decades was driven by the singular fixation upon reducing operating expenses and that counted upon stability driven by steady globalization. Companies across multiple sectors are now grappling with multiple vulnerabilities because of higher border frictions that impair the ability to get product on time if at all and at higher cost. Simply put, their supply chains are spread far too thin and are more vulnerable than ever to abrupt disruptions. That, in turn, raises financial distress costs ranging from foregone sales to the extreme case of outright bankruptcy. To right the ship, a rebalancing across supply chains may tilt further toward tolerating higher expenses—and passing them on where possible—in order to lower financial distress costs.

There is a lot of uncertainty around various effects. No macro model rooted in past relationships can hope to anticipate the effects. No central bank would go out on a limb in the crafting of near-term policy by referencing longer-term risks. Markets are incapable of pricing such uncertainties that far out in time as liquidity and risk tolerance around such positioning drops off to being scant to nil.

The consequences, however, could be powerful drivers of the global macro environment for years to come. Companies may be wise to hold higher inventories given the dents to the JIT model. Companies may return to placing a premium upon more open, democratic and stable systems closer to where consumption occurs. That could motivate a shift in employment patterns toward those home markets and away from the regions of the world that benefited from one-way outsourcing. All of that, in turn, spells structurally higher inflation as part of the incidence effects attached to passing on the consequences to various stakeholders.

Chart 3

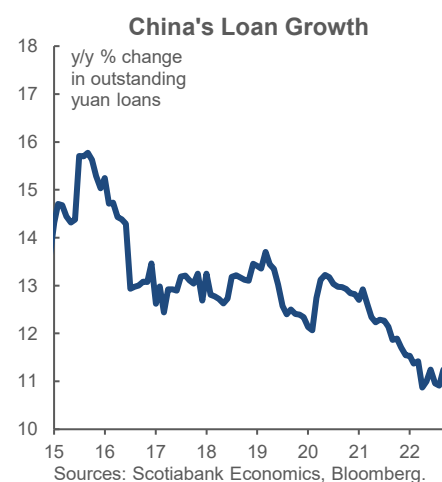
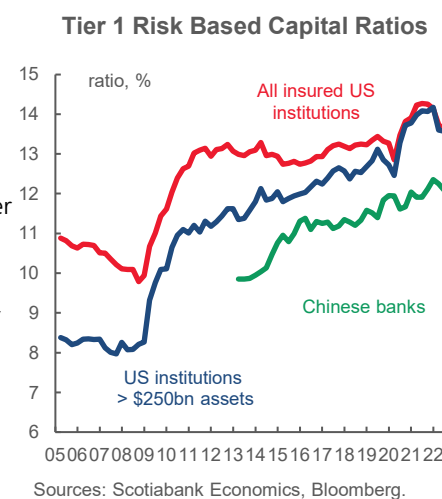


Chart 4



Fixed Income	Government Yield Curves (%):												Central Banks	
	2-YEAR			5-YEAR			10-YEAR			30-YEAR			Current Rate	
	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk		
U.S.	4.51	4.48	4.54	3.92	3.89	4.01	3.74	3.70	3.83	3.77	3.73	3.93	Canada - BoC	3.75
CANADA	3.92	3.88	3.97	3.22	3.17	3.36	2.98	2.93	3.12	3.00	2.96	3.21	US - Fed	4.00
GERMANY	2.18	2.11	2.11	2.00	1.90	1.99	1.97	1.85	2.01	1.87	1.79	1.93	England - BoE	3.00
JAPAN	-0.02	-0.02	-0.03	0.10	0.08	0.09	0.25	0.25	0.25	1.49	1.46	1.41		
U.K.	3.27	3.21	3.18	3.27	3.22	3.30	3.10	3.04	3.24	3.33	3.28	3.39		
	Spreads vs. U.S. (bps):													
CANADA	-59	-60	-56	-70	-72	-65	-76	-76	-71	-77	-77	-72	Euro zone - ECB	2.00
GERMANY	-233	-237	-243	-192	-199	-202	-177	-185	-182	-190	-194	-200	Japan - BoJ	-0.10
JAPAN	-453	-451	-456	-382	-380	-392	-348	-345	-358	-228	-227	-252		
U.K.	-124	-127	-136	-66	-67	-72	-63	-66	-59	-44	-46	-54	Mexico - Banxico	10.00
Equities	Level						% change:							
	Last	Change			1 Day	1-wk	1-mo	1-yr						
S&P/TSX	20344	61.8			0.3	1.8	6.5	-5.9					Australia - RBA	2.85
Dow 30	34194	96.0			0.3	1.9	8.6	-4.5					New Zealand - RBNZ	4.25
S&P 500	4027	23.7			0.6	1.7	6.1	-14.3						
Nasdaq	11285	110.9			1.0	0.9	3.0	-28.8						
DAX	14521	-18.2			-0.1	0.6	11.2	-8.8						
FTSE	7471	4.8			0.1	1.2	6.5	2.2						
Nikkei	28283	-100.1			-0.4	1.3	4.3	-1.6					Canada - BoC	Dec 07, 2022
Hang Seng	17574	-87.3			-0.5	-2.3	18.2	-27.0					US - Fed	Dec 14, 2022
CAC	6703	-4.3			-0.1	0.9	7.2	-5.3						
Commodities	Level						% change:							
		Change			1 Day	1-wk	1-mo	1-yr						
WTI Crude	78.71	0.77			1.0	-3.6	-7.7	0.4					England - BoE	Dec 15, 2022
Natural Gas	7.16	-0.15			-2.0	12.5	27.6	41.3					Euro zone - ECB	Dec 15, 2022
Gold	1747.65	-7.59			-0.4	-0.2	5.7	-2.3					Japan - BoJ	Dec 20, 2022
Silver	21.56	0.30			1.4	2.3	12.2	-8.2						
CRB Index	276.87	-2.37			-0.8	-0.3	1.9	16.2						
Currencies	Level						% change:							
		Change			1 Day	1-wk	1-mo	1-yr						
USDCAD	1.3393	0.0056			0.4	0.1	-1.6	5.9					Mexico - Banxico	Dec 15, 2022
EURUSD	1.0358	-0.0052			-0.5	0.3	3.9	-7.6					Australia - RBA	Dec 05, 2022
USDJPY	139.47	0.9300			0.7	-0.6	-5.7	20.9						
AUDUSD	0.6726	-0.0038			-0.6	0.8	5.2	-6.5						
GBPUSD	1.2070	-0.0043			-0.4	1.5	5.2	-9.4					New Zealand - RBNZ	Feb 21, 2023
USDCHF	0.9497	0.0065			0.7	-0.5	-4.6	1.5						

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