SMBC Capital Markets, Inc.

fxPoetry

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Spending Spree

Apparently, President Xi
Is now focused on MMT
A trillion more yuan
Is what he'll add on
To go on a new spending spree

If I'm doing the math correctly, after last night's announcement of an additional 1 trillion yuan of stimulus, it appears that the Chinese government has added some 4.5 trillion yuan in stimulus to the economy in the past three months. As well, you will recall, they cut interest rates last week, so it seems pretty clear that President Xi is growing increasingly nervous about the economic outcome in China as he heads into the big CCP shindig in October where he is seeking to be named President ~~for life~~ for an unprecedented third term. Ultimately, the combination of his zero Covid policy, the imploding property sector and stresses from dramatically higher energy prices have undermined his plans for 5.5% GDP growth this year. In fact, most economists estimate that China will grow somewhere around 3.0%, perhaps not quite as much common prosperity as Xi was seeking.

But as is often the case, the short-term influence on market activity of an announcement of this nature was substantial. The risk bulls took this news and grabbed as much risk as possible driving equities in Asia higher (Nikkei +0.6%, Hang Seng +3.6%, Shanghai +1.0%) with the property sector, mainly listed in Hong Kong, being the biggest beneficiary. Unfortunately for President Xi, that CNY 4.5 trillion pales in comparison to the value that has been destroyed by the property sector, with estimates that prior to the Evergrande problems which signaled the start of the crisis, were as high as $60 trillion. You read that correctly, the Chinese property sector was believed to be the largest market segment of any in the world. I fear there is more air to come out of that bubble before things are done, and that does not bode well for risk overall.

But this news also helped metals markets led by copper (+1.4%) and gold (+0.7%) with aluminum (+0.2%) lagging a bit. Given the idea that this stimulus is to be devoted to infrastructure, it makes sense that copper is on the rise. Interestingly, energy prices are more mixed this morning, with oil (-0.1%) consolidating its recent gains while NatGas (-0.85%) is doing the same. I'm sure the

Europeans and Brits wished that gas prices were falling as once again they are setting records with Europe (+6.1%) and the UK (+9.7%) continuing higher amid ongoing concerns that Russia is going to turn off the taps for good. As a point of comparison, European NatGas is now trading at $90/MMBtu compared to $9.25 in the US!

I continue to see anecdotes of how rising energy prices are crippling European companies and quite frankly, I am amazed that any company remains open. We have seen ammonia and fertilizer plants closing, we have seen aluminum and nickel smelters closing and we have seen stories of bakeries and restaurants cutting back so drastically as to effectively be closing, all due to the cost of energy. The bigger problem is that the political response to all of this pain is to throw more money at the situation to support those companies and people who are suffering. However, all this does is support demand for a product in short supply and drives prices higher. Based on this behavior, perhaps that Citibank analyst who forecast 18.6% CPI in the UK by January may be underestimating the situation.

There was one other wrinkle from China last night, and that took place in the FX markets where the PBOC set its fixing rate 120 pips stronger (USD lower) than market expectations as the first shot across the bow of the renminbi's recent steady decline. For instance, the Chinese currency had fallen more than 2% in the past two weeks prior to last night's PBOC action. It appears that the PBOC may well still be concerned about the 7.00 level as the point where funds begin to flow out of the country.

The reason for all the China discussion is that as market participants await Chairman Powell's speech tomorrow, nothing else has seemed to matter very much. For instance, German IFO readings were all softer in August than July, but did beat expectations, and German GDP for Q2 was revised to +0.1% from 0.0%, hardly the stuff of rallies. Too, French Confidence readings were all softer than last month, but better than expected, so perhaps the European decline is not as bad, or at least not yet perceived as such, as had been previously thought.

The impact, however, of this data in Europe has been fairly benign. Equity markets there are either side of unchanged with no major index having moved even 0.2%. European bond markets, though, are seeing some love this morning with Bunds (-3.1bps), OATs (-3.3bps), Gilts (-5.7bps) and BTPs (-6.0bps) all rallying and that all important Bund – BTP spread narrowing a few ticks to 230bps. Treasuries (-1.7bps), too, are rallying after a pretty sharp selloff yesterday in the US session, seemingly on slightly better than expected Durable Goods ex transportation data.

Finally, the dollar is broadly lower this morning, retracing some of is recent gains but still higher on the week. So, while the euro has edged up by 0.15%, it remains below parity. AUD (+0.9%) is the G10 leader followed by NZD (+0.8%) both of which have benefitted directly from the Chinese stimulus announcement. NOK (+0.6%) is next on the list with this week's oil rally supporting the krone. But the whole bloc is higher this morning.

The same is largely true in emerging market currencies with THB (+0.6%) and ZAR (+0.55%) the leaders as both these, and most APAC currencies have benefitted from the Chinese stimulus announcement. Meanwhile, KRW (+0.5%) rallied after the BOK raised rates the expected 25bps, and of course on the Chinese news and the rest of the space is mostly firmer as well.

On the data front, we do get some important things this morning with Initial Claims (exp 252K), Continuing Claims (1441K) and the second look at Q2 GDP (-0.7%, up from -0.9% initially) all at

8:30. The Atlanta Fed gave us two more bits of information as well. First, the GDPNow Forecast for Q3 fell to 1.4% from 1.6% prior to the PMI data and then in a WSJ interview, Raphael Bostic explained that he was torn between 50bps and 75bps right now, but strong data would tip him toward the latter. Obviously, he was considering the NFP and CPI data to be released before the next FOMC meeting.

The dollar has rallied a long way in a fairly short time and at this point, all eyes remain on Chairman Powell's speech tomorrow. My sense is we are likely to see some position squaring which means that a bit more dollar weakness could well be on the cards ahead of Powell. Remember, too, that tomorrow morning at 8:30 we see the PCE data the Fed watches closely. So, there is still much new information ahead of us.

Good luck and stay safe
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