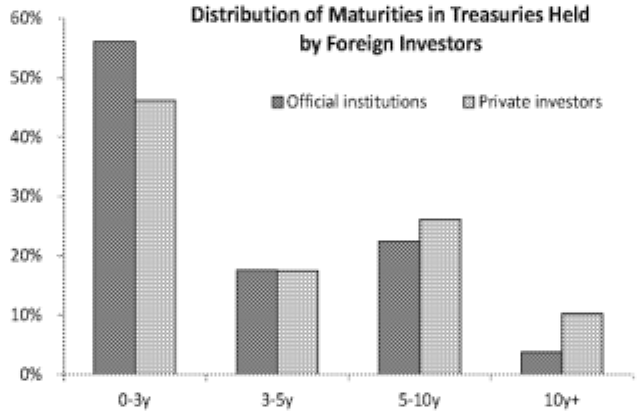
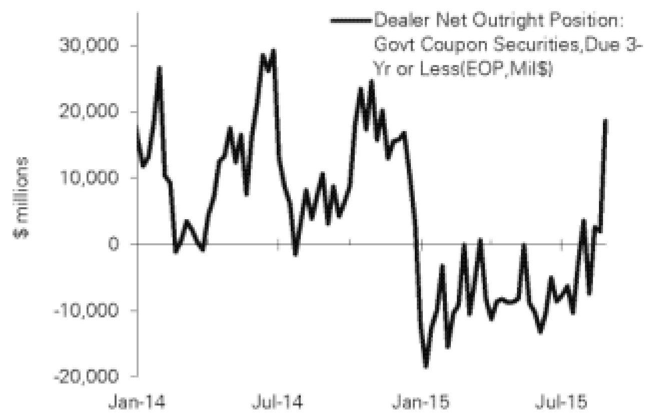
Even without considering the empirical relationships, it is also clear that FX intervention is very much a short term affair. As the chart below shows the recent jump in dealer positions in less than three years is consistent with the Treasury data for 2014 that shows the preponderance of foreign official Treasury holdings is held in the sub 3 year sector. Very little is held in longer dated maturities so any FX intervention is anyway more likely to flatten the yield curve than steepen it.

About 56% foreign official holdings of Treasuries are under three years in maturity



Source: Treasury and Deutsche Bank

Dealer positions in Treasuries maturing in 3 years or less



Source: Fed and Deutsche Bank

The relationship between central bank liquidity and the byproduct of FX reserve accumulation is clearly central to risk asset performance and therefore interest rates. The simplistic error is to assume that all assets are treated equally. They are not – or at least have not been especially since the crisis. If liquidity weakens and risk assets trade badly, rates are most likely to rally not sell off. It doesn't matter how many Treasury bills are redeemed or USD cash is liquidated from foreign central bank assets, US rates are more likely to fall than rise especially further out the curve. In some ways this really shouldn't be that hard to appreciate. After all central bank liquidity drives broader measures of liquidity that also drives, with a lag, economic activity. The indicators of excess liquidity (see below) are but derivatives of central bank liquidity and the bank or "inside" money multipliers. If liquidity is tightening relatively to nominal growth, real growth will tend to slowdown later. Right now the message is not good for the OECD, excess liquidity indicators point to real growth losing momentum. The IMF seems to get the picture. China is probably getting the picture but faces the conundrum of how to manage the carry trade unwind with minimal disruption. The grass is definitely though greener if the currency is weaker and they hang onto most of their reserves. Ironically the excess liquidity indicator has recently improved for China although this is as much to do with decelerating nominal growth.