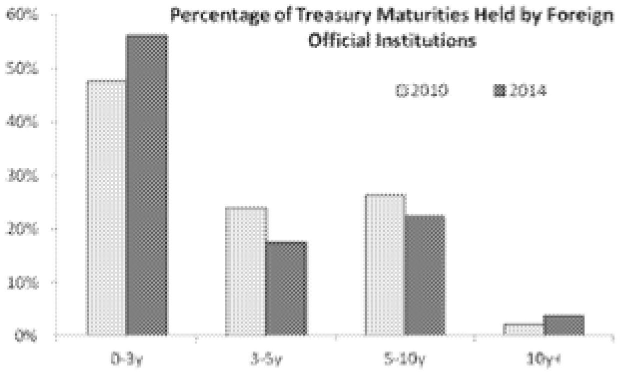
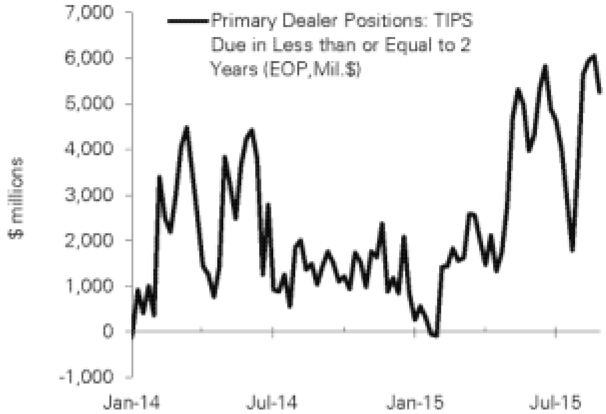
There has been an increased concentration in short dated Treasury holdings by foreign official institutions



Source: Treasury and Deutsche Bank

Dealer positions in TIPS maturing in less than or equal to 2 years



Source: Fed and Deutsche Bank

How much did intervention-related flows affect dealer positions in the past? To answer that question, we analyzed Japan's foreign exchange operations in US dollars and dealer positions in short dated coupon Treasuries from 1991 to the present. The most recent operations occurred in 2010 and 2011, when Japan bought US dollars and sold yen. The operations that sold US dollars and bought yen were less frequent and have not occurred since 1998. It was evident that dollar buying foreign exchange operations coincided with a decline in dealer positions in short dated Treasuries, but the effects were not overwhelming.

On a related note, there has been an uptick in PBoC's OMO net injections of funds recently, in the order of CNY215 billion in the second half of August, which came along with the CNY depreciation. Last time when the net injections in this order of magnitude occurred was late February.

Opportunities abound in inflation markets

Volatility in inflation markets has continued along with commodities and equities, creating opportunities for active traders. We like being long front end breakevens in forwards, e.g., one-year breakevens implied by short maturity TIPS, such as the 7/2016s and the 7/2017s, currently trades around 1.3%.

One can also hedge out energy prices in that trade to create a synthetic exposure to core CPI. For example, one can use gasoline RBOB futures Dec16 and Dec17, which have higher open interest than neighboring contracts, taking advantage of the contango. The average core CPI over the past ten years is about 1.9%. Only briefly in 2010, did the year-over-year core CPI dipped below 1.0%.