

Situation Room

The return of contagion

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Contagion from US bank stress returned today. First, stress spilled over to Europe with focus on Credit Suisse (CS). Second, big declines in US and European interest rates and oil prices suggest the volatility in the banking sector is beginning to negatively impact the outlook for the global economy. Third, First Republic Bank (ticker FRC) was downgraded to high yield. The silver lining is that the contagion should increase the chance of additional regulatory response. In fact, The Swiss National Bank (SNB) announced in the afternoon that it will provide liquidity to CS if necessary.

Spillover to Europe

News reports that Saudi National Bank would not provide additional equity capital to CS sent the bank's 1yr CDS to over 800bps. CS's share price declined a further 24% today. In sympathy, European bank stock prices were down 8.4%, including down 16.6% for the three biggest French banks. Since March 3rd, CS is the clear underperformer among the large European banks (-39%), down from -20% for SOCCGEN and INTNED.

Daily credit snapshot

No IG new issue supply priced in the market today. S&P 500 closed -0.70%, 10-year Treasury yields -23bps, CDX IG +3.6bps, CDX HY -\$0.60pts, and cash bond spreads quoted from 5 to 20bps wider today, LQD closed 5bps wider today.

Daily dealer inventories update

-\$739mn (notional), -\$809,000 (DV01) today. Maturities and sectors inside.

Daily foreign demand tracker

We track dealer-to-affiliate volumes on Trace that are correlated with foreign buying.

15 March 2023

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United States
Cross Product

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Credit Strategy

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Research Overview — The Situation

The return of contagion

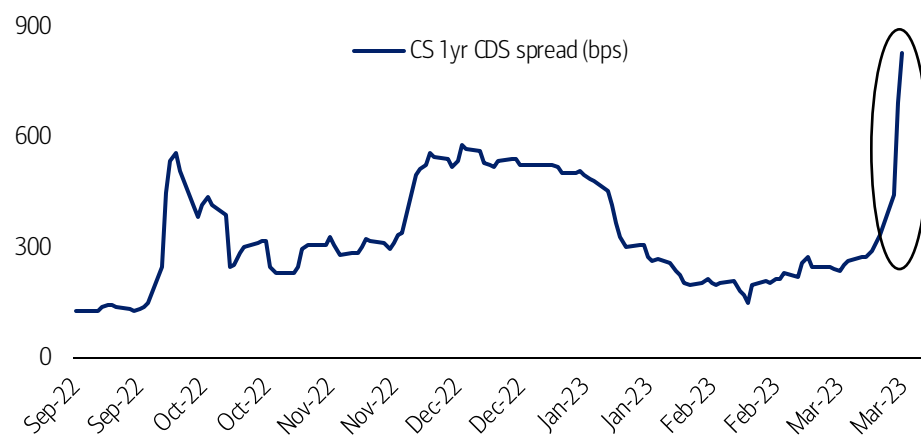
Contagion from US bank stress returned today. First, stress spilled over to Europe with focus on Credit Suisse (CS). Second, big declines in US and European interest rates and oil prices suggest the volatility in the banking sector is beginning to negatively impact the outlook for the global economy. Third, First Republic Bank (ticker FRC) was downgraded to high yield. The silver lining is that the contagion should increase the chance of additional regulatory response. In fact, The Swiss National Bank (SNB) announced in the afternoon that it will provide liquidity to CS if necessary.

Spillover to Europe

News reports that Saudi National Bank would not provide additional equity capital to CS has sent the bank's 1yr CDS to over 800bps (Figure 1). CS stock price declined a further 24% today. In sympathy European bank stock prices were down 8.4%, including down 16.6% for the three biggest French banks. Since March 3rd CS is the clear underperformer among the large European banks (-39%), down from -20% for SOCCGEN and INTNED (Figure 2).

Figure 1: CS 1yr CDS widened to over 800bps on Wednesday March 15

1yr CS CDS was trading at 240bps at the end of February.



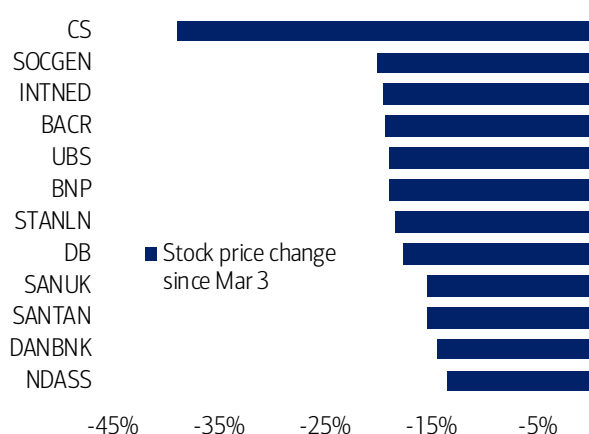
Source: BofA Global Research

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European Yankee bank bonds total \$533bn in the US IG index. CS is the second largest European Yankee bank with \$45bn in index notional, behind \$82bn for HSBC. By country UK banks have the most bonds in the US IG index (\$216bn), followed by France (\$105bn) and Switzerland (\$77bn Figure 3).

Figure 2: CS was a clear underperformer in terms of equity price

Among the largest European bank stocks CS has underperformed the most since March 3rd.

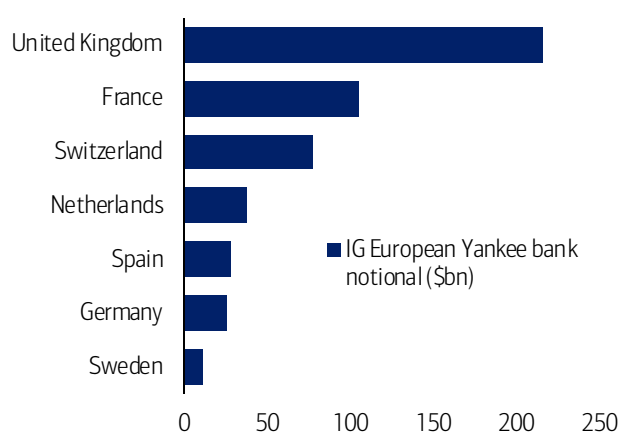


Source: BofA Global Research, Bloomberg

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Figure 3: UK and French banks have the most IG Yankee debt

UK (\$216bn) and French (\$105bn) banks have the most Yankee bonds outstanding in the US IG index.



Source: BofA Global Research, ICE Data Indices, LLC.

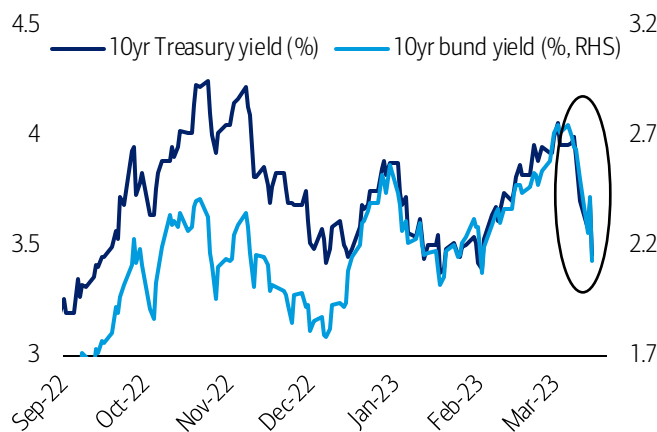
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Weaker growth outlook

The sharp drop in global interest rates and Brent oil price suggests worsening global growth outlook. 10yr Treasury and bund yields are down 54bps and 52bps since March 8, respectively (Figure 4). Brent oil price declined to 74.4 today, down 11% in March and has reached the lowest price since December 2021, which is before the start of the conflict in Ukraine (Figure 5).

Figure 4: US and European interest rates declined precipitously

10yr Treasury and bund yields are down 54bps and 52bps since March 8, respectively

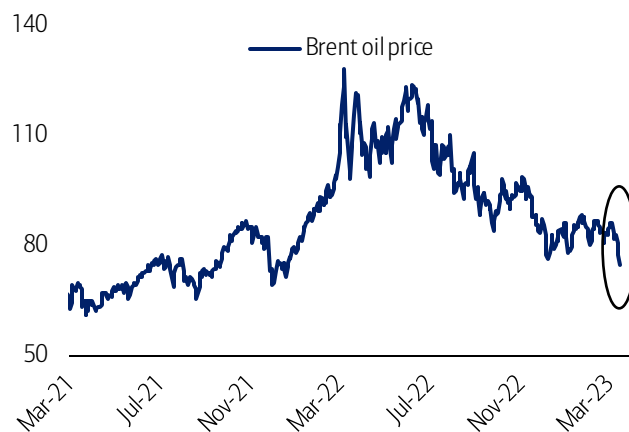


Source: Bloomberg.

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Figure 5: Brent oil price dropped to the lowest level since Dec-2021

Brent oil price reached \$74.4 today, which is down 11% in March and is the lowest level since Dec 2021, prior to the start of the conflict in Ukraine.



Source: Bloomberg.

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Downgrades to HY

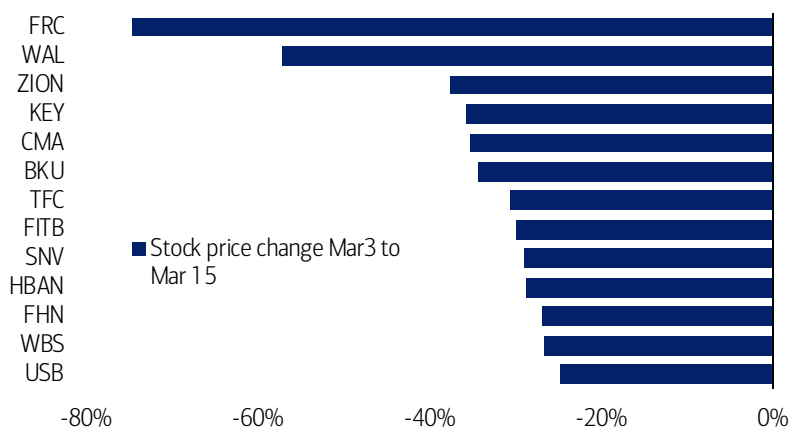
Both S&P and Fitch downgraded First Republic Bank (ticker FRC) to high yield today, sighting elevated risk of deposit outflows. FRC has two bonds in the US IG index, with total notional of \$800mn.

Notably, FRC is the IG regional bank / finance company that has underperformed the most in the equity market during this bout of bank stress, excluding the failed banks (Figure 6). That suggests relatively lower downgrade risk for the remaining issuers. Finally, it could take some time to get more clarity on funding stress for the regional banks, and how it is ultimately impacted by the Fed's Bank Term Funding Program (BTFP).



Figure 6: FRC stock has underperformed other regional banks / finance IG issuers

FRC stock is down 75% since Mar3, below -57% for WAL and -38% for ZION.



Source: BofA Global Research, Bloomberg

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Credit Strategy

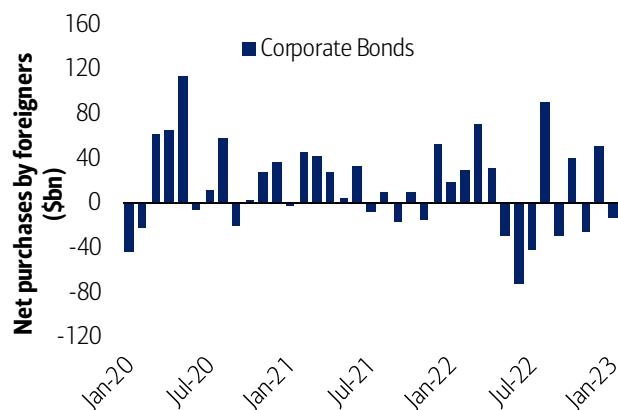
TIC update for January

According to TIC (Treasury International Capital) data released today foreign investors net sold -\$12.7bn of US corporate bonds (excluding ABS) in January, after net buying +\$51.2bn in December (Figure 7). Note that the net purchase amount is based on monthly market value of securities holdings, adjusted for the price change. In January foreign investors net sold -\$45.6bn of Treasuries, after net buying +\$57.8bn in December. Foreign investors also net bought +\$31.3bn of stocks, +\$9.8bn of Agency MBS and +\$5.7bn of Agencies (Figure 8).

By region, where data includes ABS, European investors net sold -\$4.3bn, Asia net sold -\$6.3bn and the Caribbean net sold -\$11.1bn (Figure 9). Within Asia, Japan net sold -\$6.6bn, China net bought +\$0.7bn, while the rest of Asia net sold -\$0.4bn (Figure 10). Notice that this data on the geographical breakdown of foreign purchases is fairly useless as it tracks the money manager or the custodian – i.e. often not the root source of demand.

Figure 7: Foreign net purchases of corporate bonds (excl. ABS)

Foreign investor flows have been mixed over the past few months.



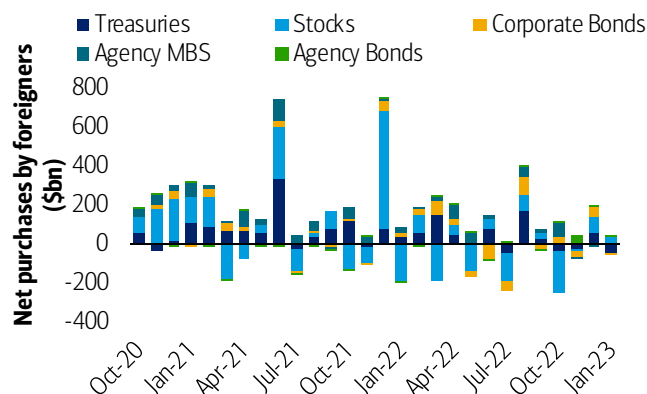
Note: net purchases are based on monthly market value of security holdings, adjusted for the price change.

Source: TIC system, BofA Global Research

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Figure 8: Monthly foreign net purchases of long-term US securities

Foreign investors were net buyers of US stocks, agency MBS and agency bonds in January, while they were net sellers of US treasuries and corporate bonds.



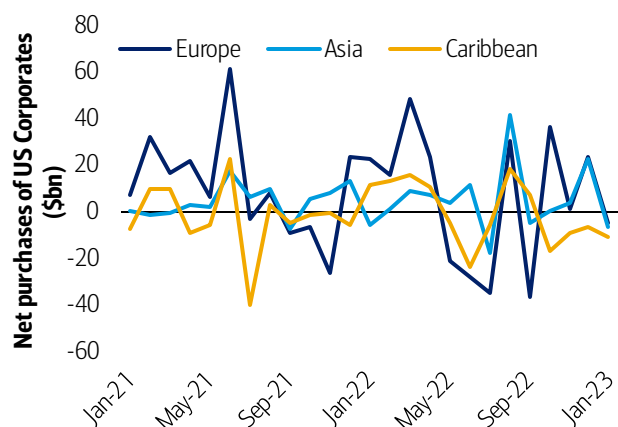
Note: net purchases are based on monthly market value of security holdings, adjusted for the price change. Agency MBS excludes prepayments.

Source: TIC system, BofA Global Research

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Figure 9: Net purchases of US corporate bonds by region (incl. ABS)

Europe, Asia and the Caribbean were all net sellers of US corporate bonds in January.



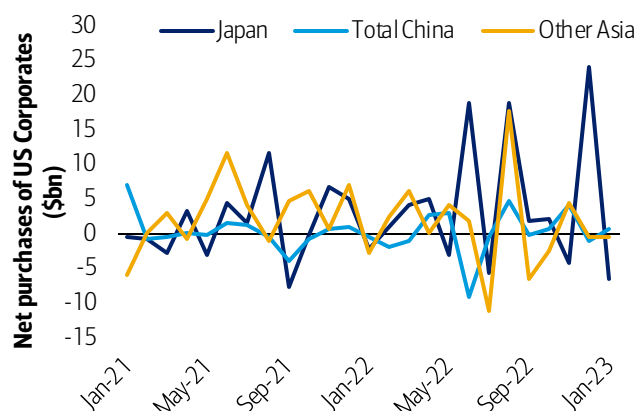
Note: net purchases are based on monthly market value of security holdings, adjusted for the price change.

Source: TIC system, BofA Global Research

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Figure 10: Net purchases of US corporate bonds by Asia (incl. ABS)

Within Asia, China was a net buyer of US corporate bonds in January, while Japan and the rest of Asia were net sellers.



Note: net purchases are based on monthly market value of security holdings, adjusted for the price change.

Source: TIC system, BofA Global Research

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Daily credit snapshot

No IG new issue supply priced in the market today.

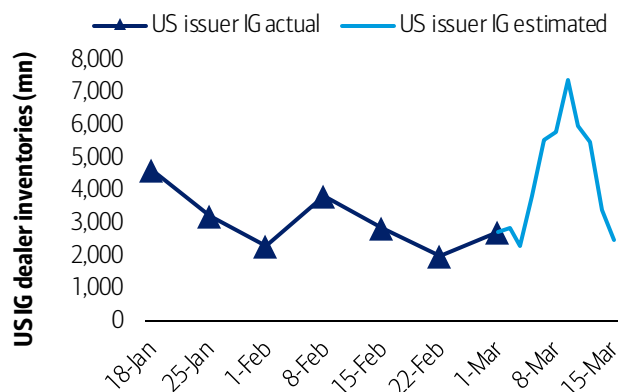
S&P 500 closed -0.70%, 10-year Treasury yields -23bps, CDX IG +3.6bps, CDX HY - \$0.60pts, and cash bond spreads quoted from 5 to 20bps wider today, LQD closed 5bps wider today.

Daily dealer inventories update

Below we estimate dealer inventories for the IG corporate bonds based on TRACE data. The actual inventories of US issuer bonds based on NY Fed survey, as well as the estimated change since the latest Fed report are plotted in Figure 11 and Figure 12. We estimate the corresponding DV01 equivalent in Figure 12. More details by sector and maturity are available in Figure 13 and Figure 14. Finally, note that the data for the current date is through about 4:40 p.m. Eastern Standard Time.

Figure 11: Estimated dealer inventories of IG corporate bonds.

We estimate IG dealer inventories of US issuer bonds declined to \$2.5bn currently from \$2.7bn on Mar-01.



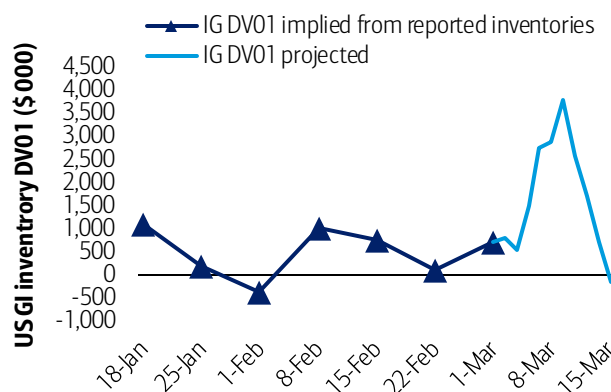
Note: data for US issuer bonds only, maturities 13M or longer. Actual dealer inventory data is from Primary Dealer Statistics survey by the NY Fed. The subsequent change in inventory is estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE, Federal Reserve

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Figure 12: Estimated dealer inventory DV01 for IG corporate bonds.

We estimate IG dealer inventory DV01 of US issuer bonds declined to -\$0.2mn currently from \$0.7bn on Mar-01.



Note: data for US issuer bonds only, maturities 13M or longer. Actual dealer inventory data is from Primary Dealer Statistics survey by the NY Fed. The subsequent change in inventory is estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE, Federal Reserve

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Figure 13: Estimated changes in IG dealer inventories by maturity and broad sector.

We estimate IG dealer inventories declined -\$739mn today and declined -\$3,074mn over the prior week.

Sector	Net dealer buy (\$mn)					Net dealer DV01 change (\$thousand)					Trading volumes on 15-Mar-23 (\$mn)			
	15-Mar	14-Mar	1 W	2 W	4 W	15-Mar	14-Mar	1 W	2 W	4 W	Buy	Sell	Dealer	Total
High grade (13M+)	-739	-1,945	-3,074	2,099	5,455	-809	-865	-3,002	471	2,972	10,500	11,239	6,726	28,466
<3yr	119	-251	395	821	1,148	23	-51	54	166	203	1,643	1,525	1,214	4,382
3-5yr	-178	-986	-1,149	-180	-126	-79	-348	-492	-175	-172	1,989	2,166	1,644	5,799
5-11yr	-288	-757	-1,008	1,701	3,948	-211	-478	-742	925	2,289	3,951	4,239	2,100	10,291
11+yr	-392	50	-1,312	-242	485	-542	11	-1,822	-444	652	2,917	3,309	1,768	7,994
Fin	-61	-232	-244	1,765	3,638	-193	0	-590	747	1,611	5,492	5,553	2,422	13,467
Non-Fin	-678	-1,713	-2,830	334	1,816	-616	-865	-2,411	-276	1,361	5,008	5,686	4,304	14,998
Fixed	-711	-1,945	-3,101	2,133	5,301	-759	-865	-2,960	508	2,941	10,410	11,121	6,658	28,188
Floating	-28	0	27	-34	153	-50	0	-41	-37	31	91	118	68	277
US issuers	-937	-2,079	-3,285	-212	740	-882	-969	-3,009	-854	622	6,930	7,867	5,635	20,433
DM Yankees	186	136	225	1,986	3,804	56	114	4	1,127	1,828	3,326	3,139	1,014	7,479
EM Yankees	12	-2	-14	325	911	16	-10	3	198	522	245	232	77	554

Note: data for maturities 13M or longer. Changes in inventories are estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE.

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Figure 14: Estimated changes in IG dealer inventories by sector.

We estimate today IG dealer inventories increased \$13mn for Banks/Brokers and declined -\$99mn for Energy.

Sector	Net dealer buy (\$mn)					Net dealer DV01 change (\$thousand)					Trading volumes on 15-Mar-23 (\$mn)			
	15-Mar	14-Mar	1 W	2 W	4 W	15-Mar	14-Mar	1 W	2 W	4 W	Buy	Sell	Dealer	Total
Aerospace/Defense	45	-122	-187	-210	-74	57	-100	-146	-154	-94	151	106	143	400
Automobiles	30	-129	-46	263	625	23	-77	-46	47	147	111	81	141	333

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	15-Mar	14-Mar	1 W	2 W	4 W	15-Mar	14-Mar	1 W	2 W	4 W	Buy	Sell	Dealer	Total
Banks/Brokers	13	-298	-240	816	1,882	-107	-11	-521	154	385	4,725	4,712	1,709	11,146
Basic Materials	-47	-6	-143	72	349	-74	-13	-129	-40	22	353	401	275	1,029
Commercial Services	-37	12	-104	-68	-215	-19	5	-75	-23	-107	23	60	75	158
Energy	-99	-80	95	567	917	-65	-34	56	387	535	410	509	460	1,380
Finance	-118	-34	-145	112	599	-95	-21	-168	-19	364	444	562	432	1,438
Food, Bev, & Bottling	-33	-81	-103	230	-94	-45	25	-78	158	-73	227	260	215	703
Health Care	-275	-361	-537	-105	-716	-288	-242	-735	-485	-194	839	1,114	756	2,709
Industrial Products	44	-103	-150	81	268	25	-69	-120	26	276	272	228	207	706
Insurance	50	49	158	584	649	22	8	99	452	476	165	115	87	367
Media & Entertainment	-11	-143	-232	76	402	-18	-61	-127	80	326	411	421	312	1,144
REITs	-6	51	-18	252	508	-13	23	0	160	385	159	164	194	517
Retail	-82	-255	-353	-352	-96	-30	-151	-186	-208	-169	333	416	408	1,157
Technology	-204	-285	-447	-72	-234	-231	-111	-411	-101	147	672	876	564	2,112
Telecom	-11	-97	-159	-94	67	25	-21	-92	-67	152	366	376	206	948
Tobacco	-33	-27	-141	-61	-21	-35	-11	-87	-38	-24	47	80	98	225
Transportation	70	-7	15	-143	-63	69	3	29	-120	-92	272	201	107	580
Utilities	-17	-5	-187	-3	453	2	8	-159	171	356	472	489	282	1,243
Other	-18	-24	-151	152	248	-11	-16	-105	92	152	49	68	56	173

Note: data for maturities 13M or longer. Changes in inventories are estimated based on TRACE.

Source: BofA Global Research, FINRA, TRACE.

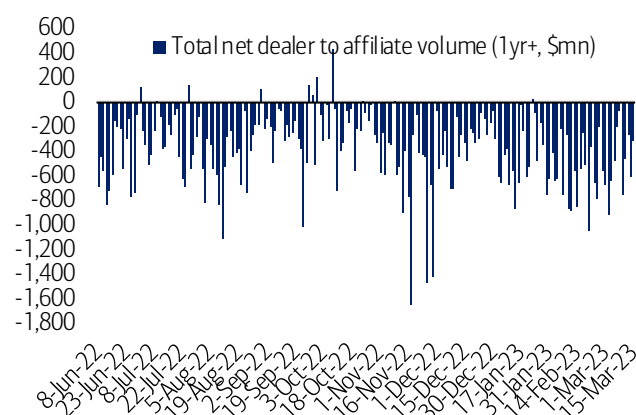
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Daily foreign demand tracker

We believe net dealer-to-affiliate volumes from Trace are correlated with foreign buying of US HG corporate bonds - i.e., negative numbers mean foreign investor buying (US dealers taking down inventory in favor of foreign affiliates). For supporting material see our "primer" on tracking foreign inflows (See: [Credit Market Strategist: One year round-trip in spreads 15 July 2016](#)). Figure 15 shows the overall daily dealer-to-affiliate volumes while Figure 16, Figure 17 and Figure 18 show subsets of this data. In particular Figure 16 shows net dealer-to-affiliate volumes for longer maturity (12+ years) bonds, Figure 17 displays volumes reported to Trace before 8am NY time (biased toward Asian buying) and Figure 18 shows the subset of net trades reported between 8am and noon (biased toward European buying).

Figure 15: Net dealer buying from affiliate (1yr+)

Figure shows inconsistent overall foreign buying of US IG corporate bonds for some time.



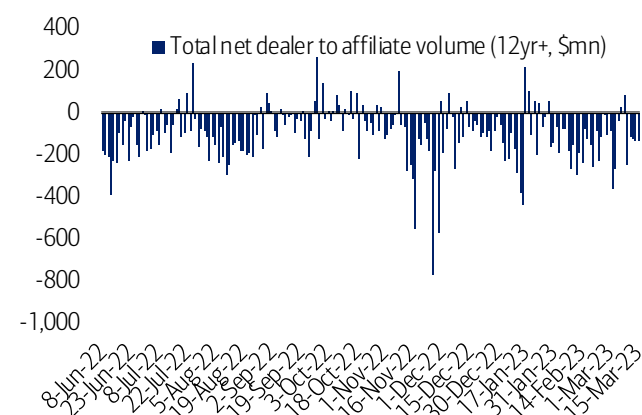
Note: Net dealer-to-affiliate volumes are correlated with foreign buying/selling. Negative numbers indicate foreign buying.

Source: Bloomberg, TRACE

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Figure 16: Net dealer buying from affiliate (12yr+)

Foreign buying of longer maturity US IG corporate bonds has been consistent this year



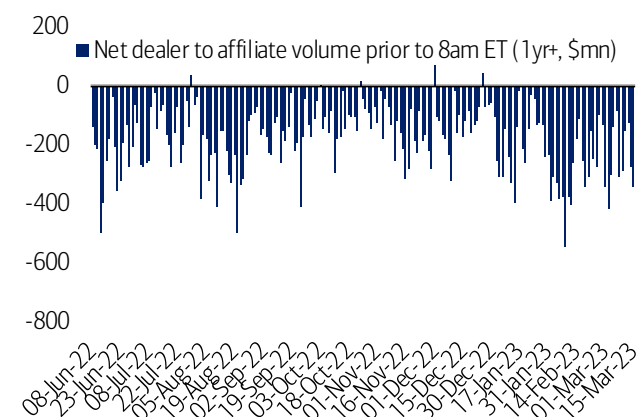
Note: Net dealer-to-affiliate volumes are correlated with foreign buying/selling. Negative numbers indicate foreign buying.

Source: Bloomberg, TRACE

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Figure 17: Net dealer-to-affiliate trading volumes before 8am ET

Foreign buying before 8am NY time is dominated by Asia and has been consistent this year



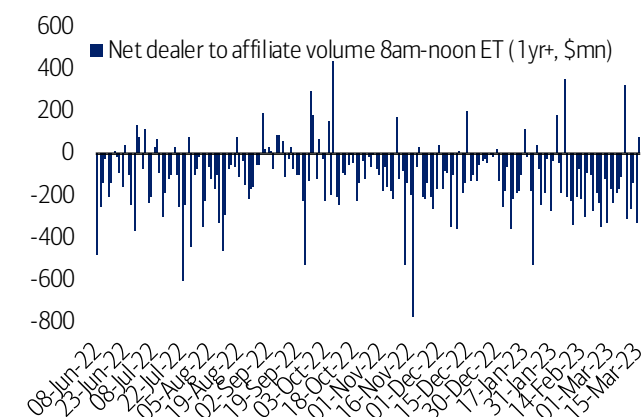
Note: Morning share of daily trading volume is correlated with secondary market activity of foreign investors due to different time zones.

Source: BofA Global Research, TRACE

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Figure 18: Net dealer-to-affiliate trading volumes 8am - noon ET

Foreign buying 8am-noon NY time is dominated by Europe and has been inconsistent this year



Note: Morning share of daily trading volume is correlated with secondary market activity of foreign investors due to different time zones.

Source: BofA Global Research, TRACE

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Common abbreviations:

IG: Investment Grade
 HG: High Grade
 LQD: iShares iBoxx \$ Investment Grade Corporate Bond ETF
 DV01: Dollar value of a basis point
 CDX IG: The Markit CDX North America Investment Grade Index
 CDX HY: Markit CDX North America High Yield Index
 ECB: European Central Bank
 QE: Quantitative Easing
 CSPP: corporate sector purchase programme
 Unchd: Unchanged
 CPI: Consumer Price Index
 FOMC: The Federal Open Market Committee



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