

Situation Room

The Fed's in the driving seat, not the BoJ

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The BoJ is expected to exit both the negative interest rate policy (NIRP) and Yield Curve Control (YCC) at their March meeting tomorrow (see [Liquid Insight: BoJ preview: Long time coming](#)). While those will be big milestones for the BoJ, they should matter little for IG corporate bond demand from Japanese investors, at least in the near term. The outlook for the Fed has a much bigger impact.

Fed > BoJ

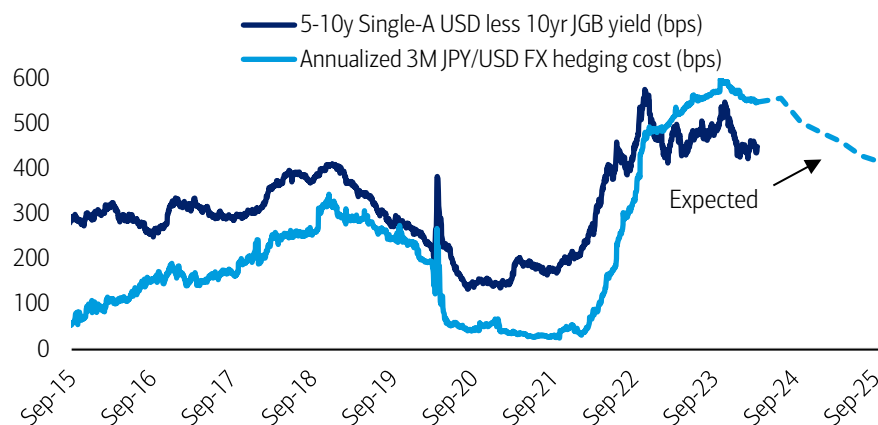
While both BoJ hikes and Fed cuts reduce FX hedging costs, our economists expect just one addition hike from the BoJ later in 2024 and three cuts from the Fed. Our strategists are calling for only a moderate increase in 10yr Japan Government Bond (JGB) yields on the back of the meeting tomorrow, while the pass through to US Treasury yields is also be limited (see [US Rates Watch](#)). US IG corporate bonds should continue to offer poor relative value for Japanese investors until FX hedging costs decline sufficiently. That would take about 100bps of Fed rate cuts, which is unlikely until 2025 (Exhibit 1).

Steady relative value and demand

The 2022 Fed hiking cycle and the big jump in FX hedging costs were the big game changers in terms of US IG relative value for Japanese investors. Then in 2023 and so far in 2024 relative value remained range bound. The story was similar on the demand side, where following volatility in 2022 buying stabilized in 2023 and so far in 2024 (Exhibit 2). Given little impact from the BoJ tomorrow we expect that to continue.

Exhibit 1: US IG corporate bonds remain unattractive to Japanese investors after FX hedging costs

Currently 5-10yr A-rated US IG (5.3% yield) is 4.5% higher than 10yr JGB yield (0.78%). That's 1% below 5.5% 3M FX hedging cost for Japanese investors.



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

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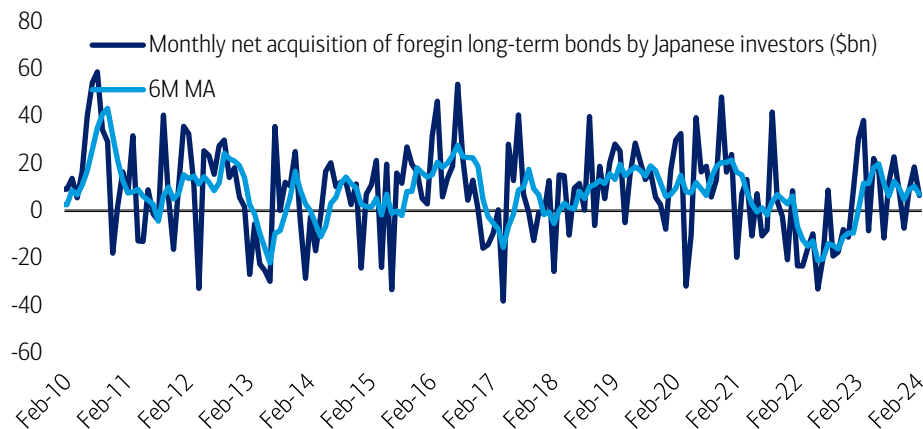
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Timestamp: 18 March 2024 06:27PM EDT

Exhibit 2: Selling in 2022, buying in 2023 and 2024

Japanese investors net sold foreign long-term bonds in 2022 but have been buyers in 2023 and so far in 2024.



Source: BofA Global Research, Japan Ministry of Finance, Bloomberg.

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Daily credit snapshot

US IG issuance totaled \$6.7bn across 8 deals today, \$6.7bn WTD and \$95.7bn MTD. The average new issue concession was 11.0bps today, while the average break performance was 5.5bps tighter today. This week's new issues are trading 1 bps wider on average from pricing.

S&P 500 closed +0.63%, 10-year Treasury yields +2bps, CDX IG -0.9bps, CDX HY +\$0.14pts, and cash bond spreads quoted Unched to -2 bp today, LQD closed 0.02bps wider today.

Exhibit 3: Recent new issue pricing and new issue concessions

List of new issues in the IG corporate bond market today along with performance metrics.

Date	Ticker	Name	Tenor	Size (\$mm)	Moody's/S&P Rating	Coupon (%)	Px Spread (bps)	New Issue Conc. (bps)	* Break performance	Current spread (bps)
2024-03-18	AEP	Appalachian Power Co	10	400	Baa1/BBB+	5.65	135	n.a.	-6	129
2024-03-18	AGCO	AGCO Corp	3	400	Baa2/BBB-	5.45	95	n.a.	n.a.	n.a.
2024-03-18	AGCO	AGCO Corp	10	700	Baa2/BBB-	5.8	150	n.a.	n.a.	n.a.
2024-03-18	CIMAU	CIMIC Finance USA Pty Ltd	10	650	Baa3/BBB-	7	275	n.a.	n.a.	n.a.
2024-03-18	NWMLIC	Northwestern Mutual Global Funding	3	650	Aaa/AA+	5.07	55	n.a.	n.a.	n.a.
2024-03-18	PCAR	PACCAR Financial Corp	10	350	A1/A+	5	70	n.a.	-1	69
2024-03-18	SRE	San Diego Gas & Electric Co	30	600	A1/A	5.55	115	n.a.	-2	113

Note: We calculate new issue concessions by estimating the difference between new issue bond spread and interpolated G spread from comparable liquid secondary bonds of the same issuer prior to the new issue deal announcement, adjusted for the spread impact of dollar prices deviating from par. Break performance is computed as the difference between new issue pricing and secondary closing spread on the first day of trading.

Source: BofA Global Research, Bloomberg

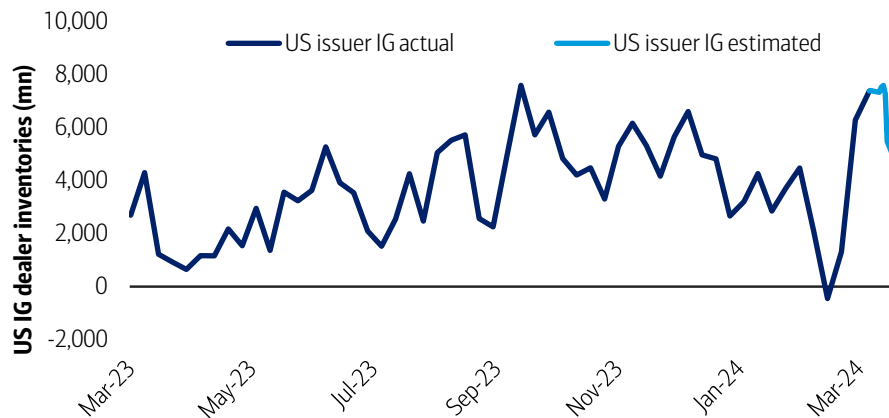
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Daily dealer inventories update

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 Exhibit 4. We estimate the corresponding DV01 equivalent in Exhibit 5. More details by sector and maturity are available in Exhibit 6 and Exhibit 7. Finally, note that the data for the current date is through about 4:40 p.m. Eastern Standard Time.

Exhibit 4: Estimated dealer inventories of IG corporate bonds.

We estimate IG dealer inventories of US issuer bonds declined to \$4.9bn currently from \$7.4bn on Mar-06.



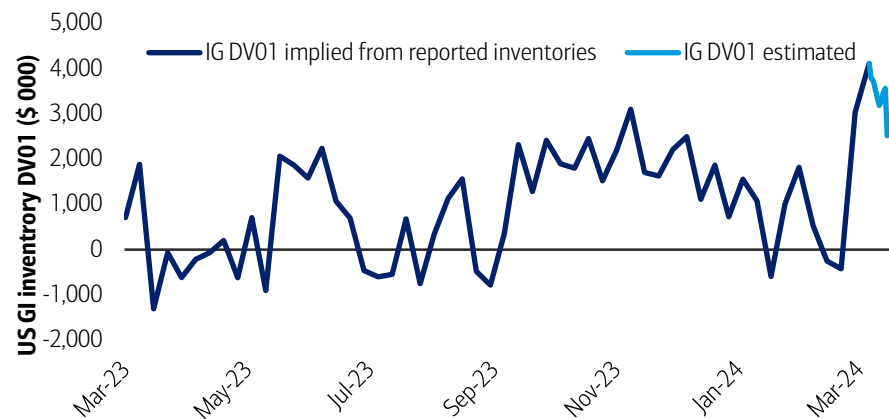
Note: data for US issuer bonds only, maturities 13M or longer. Actual dealer inventory data is from Primary Dealer Statistics survey by the NY Fed. The subsequent change in inventory is estimated based on TRACE.

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

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Exhibit 5: Estimated dealer inventory DV01 for IG corporate bonds.

We estimate IG dealer inventory DV01 of US issuer bonds declined to \$2.7mn currently from \$4.1bn on Mar-06.



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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Exhibit 6: Estimated changes in IG dealer inventories by maturity and broad sector.

We estimate IG dealer inventories declined -\$251mn today and declined -\$2,840mn over the prior week.

Sector	Net dealer buy (\$mn)					Net dealer DV01 change (\$thousand)					Trading volumes on 18-Mar-24 (\$mn)			
	18-Mar	15-Mar	1 W	2 W	4 W	18-Mar	15-Mar	1 W	2 W	4 W	Buy	Sell	Dealer	Total
High grade (13M+)	-251	-2,230	-2,840	329	12,461	591	-1,171	-159	926	7,446	11,466	11,717	10,119	33,302
<3yr	-632	-549	-1,634	-215	2,091	-120	-98	-331	-97	208	1,534	2,166	1,604	5,304
3-5yr	-223	-613	-1,431	-606	2,822	-74	-243	-496	-206	1,043	2,203	2,426	1,968	6,598
5-11yr	-71	-747	-366	283	2,479	-82	-483	-242	46	1,088	4,059	4,130	3,801	11,990
11+yr	675	-320	591	868	5,069	866	-346	909	1,182	5,107	3,670	2,995	2,746	9,411
Fin	-92	-714	-1,237	286	5,006	102	-300	-312	353	2,604	4,250	4,341	3,716	12,307
Non-Fin	-159	-1,516	-1,603	44	7,455	489	-870	153	573	4,842	7,217	7,376	6,403	20,996
Fixed	-283	-2,215	-3,176	-44	12,034	583	-1,159	-235	705	7,307	11,264	11,548	10,078	32,890
Floating	32	-15	336	373	428	7	-12	75	221	139	202	170	41	412
US issuers	-560	-1,814	-2,425	273	9,886	166	-1,045	-501	972	6,074	8,754	9,315	8,348	26,417
DM Yankees	313	-374	-272	144	1,931	428	-104	480	147	970	2,384	2,071	1,668	6,123

Exhibit 6: Estimated changes in IG dealer inventories by maturity and broad sector.

We estimate IG dealer inventories declined -\$251mn today and declined -\$2,840mn over the prior week.

	Net dealer buy (\$mn)					Net dealer DV01 change (\$thousand)					Trading volumes on 18-Mar-24 (\$mn)			
	18-Mar	15-Mar	1 W	2 W	4 W	18-Mar	15-Mar	1 W	2 W	4 W	Buy	Sell	Dealer	Total
EM Yankees	-4	-41	-144	-87	644	-4	-22	-138	-193	401	328	332	103	762

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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Exhibit 7: Estimated changes in IG dealer inventories by sector.

We estimate today IG dealer inventories increased \$120mn for Banks/Brokers and increased \$98mn for Energy.

Sector	Net dealer buy (\$mn)					Net dealer DV01 change (\$thousand)					Trading volumes on 18-Mar-24 (\$mn)			
	18-Mar	15-Mar	1 W	2 W	4 W	18-Mar	15-Mar	1 W	2 W	4 W	Buy	Sell	Dealer	Total
Aerospace/Defense	-87	-25	-259	-49	-117	-76	17	-349	-222	-302	262	349	165	776
Automobiles	79	-56	-12	126	764	45	-25	-23	-63	200	331	252	341	924
Banks/Brokers	120	-458	-398	450	3,444	235	-163	166	485	1,607	3,003	2,883	2,437	8,323
Basic Materials	23	-17	5	-2	746	24	19	21	-27	373	344	321	292	958
Commercial Services	20	-30	-135	-38	-145	26	-21	-86	29	57	236	217	200	653
Energy	98	-50	213	270	1,753	70	-73	46	-155	800	762	665	598	2,025
Finance	-84	-30	-461	-204	402	-33	3	-213	-130	211	606	690	598	1,894
Food, Bev, & Bottling	-152	-126	-311	-194	364	-24	-45	4	-54	405	358	509	363	1,230
Health Care	42	-194	99	266	162	261	-78	760	872	14	1,497	1,455	1,344	4,295
Industrial Products	-36	-125	-398	-512	-57	8	-37	-98	-281	68	242	279	212	733
Insurance	-73	-146	-176	-6	503	-78	-100	-194	23	473	421	493	300	1,213
Media & Entertainment	85	-145	112	189	911	107	-133	121	224	714	517	432	400	1,349
REITs	-55	-81	-202	45	659	-22	-40	-72	-25	314	220	275	381	876
Retail	-4	-39	-33	-98	79	49	-8	-22	-154	88	363	368	337	1,068
Technology	-45	-235	-427	52	1,039	30	-168	-53	432	977	785	831	816	2,432
Telecom	44	3	102	370	311	106	-34	75	242	192	414	370	379	1,162
Tobacco	3	-33	86	3	7	14	-10	62	15	19	86	82	108	276
Transportation	-68	8	-141	-6	161	-58	2	-114	-5	160	142	210	168	521
Utilities	-143	-405	-373	-192	1,514	-87	-242	-119	-248	1,141	746	888	539	2,173
Other	-18	-47	-131	-142	-36	-7	-35	-71	-31	-65	130	148	141	419

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

Source: BofA Global Research, FINRA, TRACE.

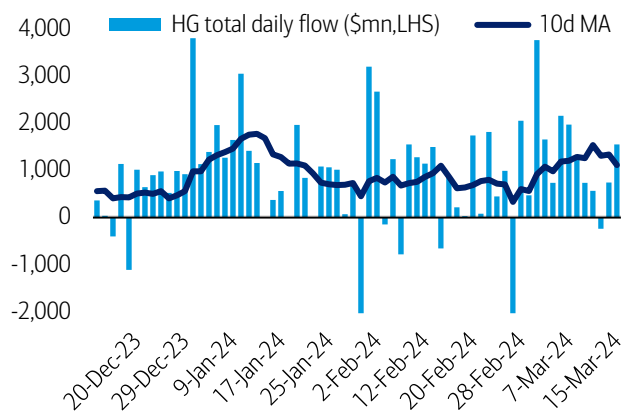
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Daily HG fund flows

We define our high grade flows as a combination of "bond" and "corporate bond" fixed income funds and ETFs domiciled in the US (and investing in any currency, although the majority is invested in USD). We also exclude funds primarily focused on Government, HY, EM and MBS from the sample. The "bond" category refers to the broad high grade market, which includes Treasuries, mortgages and agencies in addition to corporate bonds. This category accounts for the majority of AUM and flows.

Exhibit 8: Daily HG fund flows

The chart plots daily HG fund flows as well as a 10-day average trend.

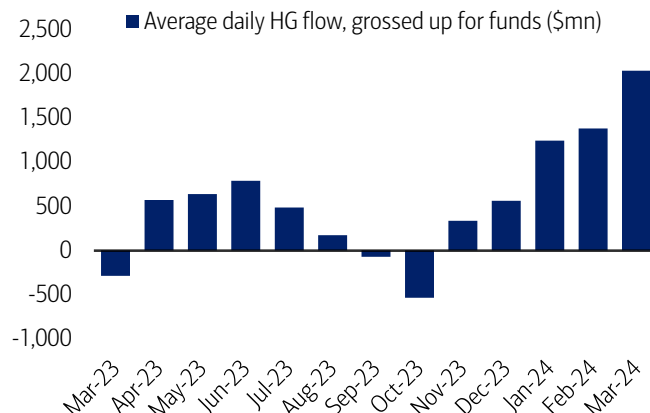


Source: EPFR Global, BofA Global Research

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Exhibit 9: Average daily HG flows by month

The chart plots the average daily ETF flows plus double the average daily fund flow, as only about half of funds report flows daily.



Source: EPFR Global, BofA Global Research

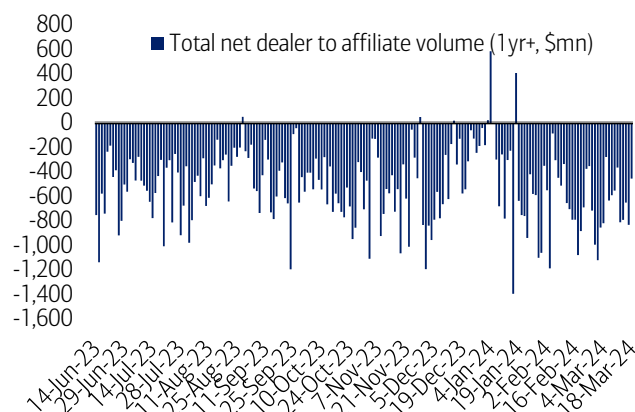
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Daily foreign demand tracker

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. Exhibit 10 shows the overall daily dealer-to-affiliate volumes while Exhibit 11, Exhibit 12 and Exhibit 13 show subsets of this data. In particular Exhibit 11 shows net dealer-to-affiliate volumes for longer maturity (12+ years) bonds, Exhibit 12 displays volumes reported to Trace before 8am NY time (biased toward Asian buying) and Exhibit 13 shows the subset of net trades reported between 8am and noon (biased toward European buying).

Exhibit 10: Net dealer buying from affiliate (1yr+)

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



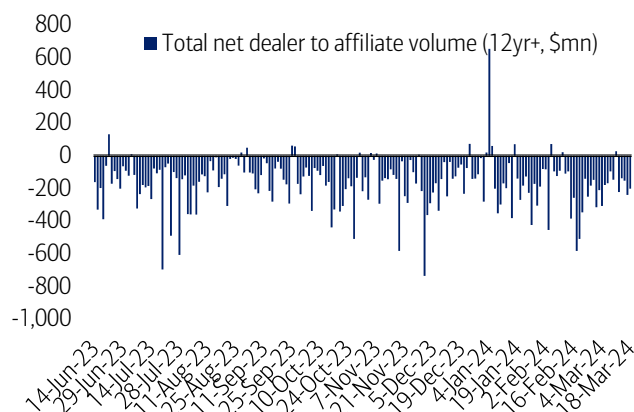
Note: Net dealer-to-affiliate volumes are correlated with foreign buying/selling. Negative numbers indicate foreign buying.

Source: Bloomberg, TRACE

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Exhibit 11: Net dealer buying from affiliate (12yr+)

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



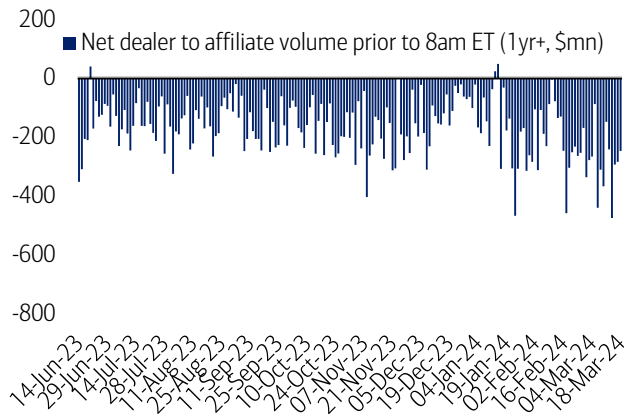
Note: Net dealer-to-affiliate volumes are correlated with foreign buying/selling. Negative numbers indicate foreign buying.

Source: Bloomberg, TRACE

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Exhibit 12: 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



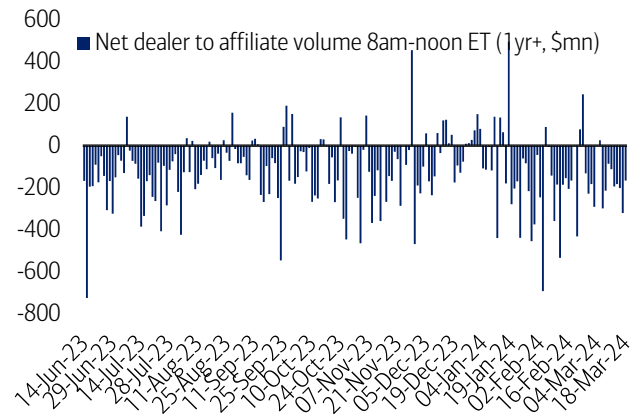
Note: Morning share of daily trading volume is correlated with secondary market activity of foreign investors due to different time zones.

Source: BofA Global Research, TRACE

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Exhibit 13: 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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