

North America Multi-Asset Focus

Foreign Flows in US Fixed Income: Strong Demand

- Foreign holdings of Treasuries increased in February, based on yesterday's TIC report. Foreign official holdings of long-term Treasuries increased by \$47bn, on a valuation-adjusted basis, compared to an increase of \$23bn holdings in January. Foreign private investors purchased \$18bn in long-term Treasuries compared to \$41bn of purchases in January.
- Foreign demand for US-issuer corporate bonds picked up in January after a dismal December, rising at the fastest rate in 15 months, although other indicators suggest that the momentum began to fade into the start of the second quarter.
- Foreign holdings of long-term Agency bonds increased in January, by \$5bn, led by foreign officials.

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Foreign Flows in US Fixed Income

Foreign demand remains strong for USTs

Foreign demand for Treasuries was strong in February based on the latest TIC report released yesterday. On a valuation-adjusted basis, foreign *officials* bought \$47bn of long-term Treasuries compared to \$23bn of purchases in January (Figure 1). Foreign *private* investors purchased \$18bn in long-term Treasuries in February compared to \$41bn of purchases in January, on a valuation-adjusted basis (Figure 1). In T-bills, foreign investors increased their holdings by \$5bn in February, led by foreign officials, who bought \$10bn, while private investors sold \$5bn.

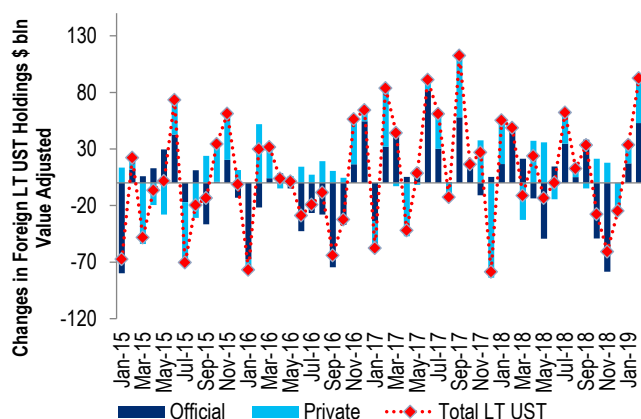
We note that TIC reports holdings data on a market value basis, which implies a net increase in holdings for February. However, this increase in holdings is understated because Treasuries sold off in February, and hence a valuation adjustment must be applied. We derive this adjustment by using the average maturity of foreign US Treasury holdings, from the annual TIC report (approximately five years), and the monthly changes in 5-year yields.

Buying from UK, Norway and Japan; Selling led by Switzerland and Taiwan

There was strong demand for long-term USTs from the UK, Norway, and Japan. The UK purchased \$11bn (z-score of 1.3) of USTs, which was the second time the UK had an over one sigma Treasury purchase in the last three months. We suspect that this was driven by custodial holdings for central banks given that foreign official demand was so strong in February. Japan also continued to buy USTs in 2019 with \$8bn (z-score of 0.4) of purchases, although this was less than January's \$27bn (z-score of 1.7). Demand from Norway continued to be strong at +\$7bn (z-score of 1.0) of purchases, likely due to the rebound in oil.

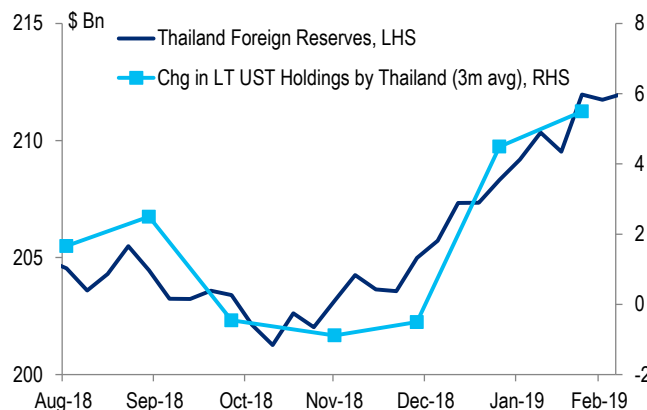
The largest net seller of long-term Treasuries was Switzerland, which sold around \$7bn (z-score of -1.7), a continuation from January, when net sales were \$6bn. There was also \$3bn (z-score of -0.9) of sales by Taiwan.

Figure 1. Breakdown of the changes in foreign long-term UST holdings between public and private investors on a valuation-adjusted basis



Source: Citi Research, Haver; Note: We calculate valuation adjusted change by adjusting the previous month's holdings by the change in 5y UST yield.

Figure 2. Thailand has continued to purchase USTs in 2019, likely driven by its increase in reserves



Source: Citi Research, US Treasury

In Asia, there was continued demand for Treasuries, which we suspect was driven by central banks. China's appetite for long-term UST picked up in February, with \$9bn (z-score of 0.4) of purchases compared to \$3bn (z-score of -0.3) of sales in January. Thailand's demand for USTs remained robust, with +\$3bn (z-score of 0.8)

of purchases following January's purchases of \$9bn (z-score of 3.3). Thailand's increase in reserves in 2019 likely drove this demand (Figure 2). In the near term, we expect central bank demand to remain relatively healthy (see [US Rates Weekly - Too much faith in soft landings](#)).

We note that country-level duration is not available from TIC, so we apply the global average maturity to the country-level data to calculate valuation-adjusted changes (Figure 3). We also note that the country attribution of foreign holdings of U.S. securities is imperfect because some foreign owners entrust the safekeeping of their securities to institutions that are neither in the United States nor in the owner's country of residence, creating a "custodial bias."

Figure 3. Foreign demand breakdown for long-term Treasuries in February

Regions	Value adjusted change, \$bn (z-score)		Market value change, \$bn			
	February LT	January LT	February LT	January LT	All Treasuries	T-bills
All foreign countries	66 (0.8)	64 (0.8)	44	85	49	5
Foreign Official	47 (1.0)	23 (0.3)	34	36	45	10
China	9 (0.4)	-3 (-0.3)	5	0	4	-1
Japan	8 (0.4)	27 (1.7)	4	31	2	-2
Euro Area ex Belgium	11 (0.4)	6 (0.1)	8	9	14	6
Belgium	4 (0.2)	-7 (-0.4)	3	-6	-10	-13
Norway	7 (1.0)	6 (1.0)	6	7	6	0
Brazil	6 (0.8)	2 (0.2)	4	3	3	-2
Caribbean	3 (0.2)	4 (0.3)	3	5	5	3
Saudi Arabia	5 (1.7)	-5 (-2.5)	4	-5	4	0
Taiwan	-3 (-0.9)	10 (2.7)	-4	11	-3	0
UK	11 (1.3)	2 (0.0)	11	3	10	0
Switzerland	-7 (-1.7)	-6 (-1.4)	-8	-5	-5	3
Russia	1 (0.2)	1 (0.3)	1	1	1	1
India	0 (-0.5)	3 (0.5)	0	3	-1	0
Thailand	3 (0.8)	9 (3.3)	3	9	3	0
Hong Kong	0 (-0.3)	8 (1.6)	-1	9	2	3

Source: Citi Research, US Treasury, Haver, Bloomberg.

Note: We calculate valuation adjusted change by adjusting the previous month's holdings by the change in 5y UST yield and assume a 5y duration which is reported in the annual TIC release. The z-score is over the full sample starting from Dec 2011.

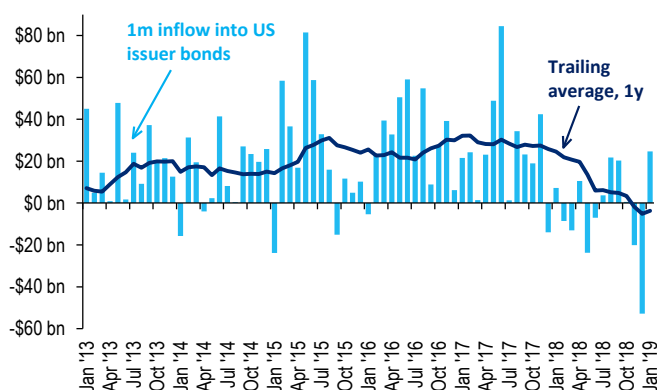
The increase in foreign official holdings, as reported by TIC for February, was higher than the ~\$21bn increase in custody holdings at the NY Fed, which holds Treasuries on behalf of foreign official accounts. The custody data is less comprehensive than the TIC dataset because not all foreign central banks leave their Treasury securities in Fed custody.

US corporate bond demand rose in January

Foreign demand for US-issuer corporate bonds picked up in January (we note that TIC data for corporates and mbs lag by one month versus Treasuries) after a dismal December, rising at the fastest rate in 15 months, according to US Treasury data that has been adjusted for market value changes. Non-US investors bought \$24.7 billion of bonds issued by US companies in all currencies, after net selling \$53 billion in December. Foreign investors have sustained the credit cycle by acquiring

an estimated half or more of net supply of US corporate bonds between 2014 and 2017, but in 2018, the pace of purchases fizzled out, contributing to a period of volatility, particularly in the fourth quarter. The new year is off to a strong start, although there are mixed signals about future demand. While US Treasury data is reported with a lag, unofficial data compiled through TRACE reporting suggest that January's momentum gradually faded into the first quarter. Citi estimates US corporate bond demand from abroad by adjusting changes in the market value of holdings reported by the US Treasury Department for fluctuations in valuations caused by moves in interest rates and exchange rates in the currencies in which US issuers have debt outstanding. Unadjusted for those market value changes, January's inflows appear markedly stronger (+\$76.9 bn).

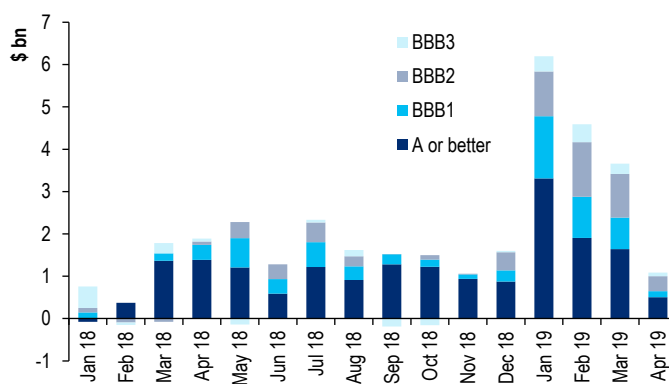
Figure 4. Estimated foreign inflow into US-issuer corporate debt, all currencies, adjusted for market value changes from FX and rates



Source: Citi Research; US Treasury

Note: Flows adjusted for market value changes in currency and rates

Figure 5. Monthly net purchases of US IG index-eligible debt by dealer affiliates, a proxy for direct overseas buying, through mid-April 2019

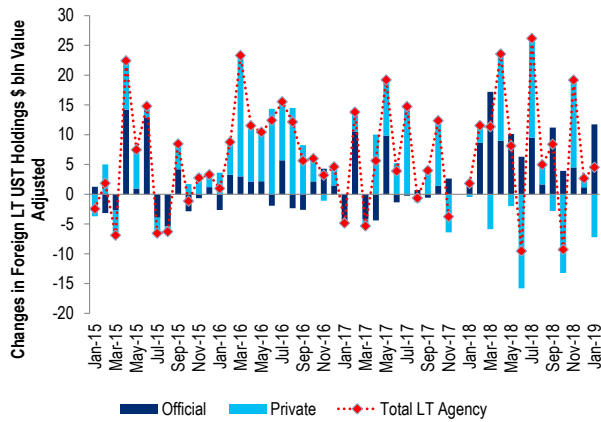


Source: Citi Research; FINRA Trace; Refinitiv

Mortgage demand picked up

Foreign holdings of long-term Agency bonds (i.e., mortgage securities) increased in January, by \$4.5bn on a value-adjusted basis, after increasing by \$2.7bn in December (Figure 6). This increase was led by \$11.7bn of purchases by foreign officials and partially offset by \$7.2bn of sales by private investors (Figure 6). Demand for mbs appears driven by China, which purchased \$13bn in January (Figure 7). We note that holdings data for mbs is released with a one-month lag compared to Treasury securities.

Figure 6. Foreign holdings in mbs increased in January led by foreign officials



Source: Citi Research, Haver

Figure 7. Country-level breakdown of mbs, value-adjusted

Change in Holdings, value-adjusted (\$bn)	
Regions	Current LT Agency Bonds
All foreign countries	5
Foreign Official	12
China	13
Japan	-3
Euro Area ex Belgium	-1
Belgium	0
Brazil	0
Caribbean Banking Centers	0
Saudi Arabia	0
Taiwan	-1
United Kingdom	0
Switzerland	0
Russia	0
Hong Kong	0

Source: Citi Research, Haver

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