Global Markets Daily: The Risks (Or Not) to Foreign Demand for US Credit (Rogers)

- The risk of foreign selling of US dollar denominated assets has been front and center for the last month amid the weakening in the US dollar.
- While foreign entities still hold nearly 30% of US credit and are an important source of demand, the corporate bond market has not suffered from the same level of worry as the US treasury market over the last month.
- While there is some evidence of modest selling from foreign buyers, we don't see much evidence that foreign investor demand has materially slackened for USD-denominated corporate bonds.
- Given that the USD denominated bond market is by far the biggest and most liquid in the world, we think the bar is still quite high for a foreign flow-driven dislocation in US credit markets.

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The Risks (Or Not) to Foreign Demand for US Credit

Over the last month, trade tensions, concerns about Fed independence, and a US fiscal package that may lead to a significantly larger budget deficit have led to a rapidly weakening dollar, and concerns about outright selling of US dollar denominated assets by foreign participants. This concern has been most acute in the Treasury market where our rates strategists still find little evidence of active foreign selling. Our portfolio strategists have also examined foreign flows in the US equity market and find that foreigners have been active sellers of US equities in March and April. In today's *Global Markets Daily* we examine foreign demand for USD-denominated corporate bonds and the degree to which foreigners have been sellers of credit. We do find that foreign participants have likely been outright sellers of USD credit in April, but we still think that the bar is structurally high for a foreign flow driven dislocation in USD credit.

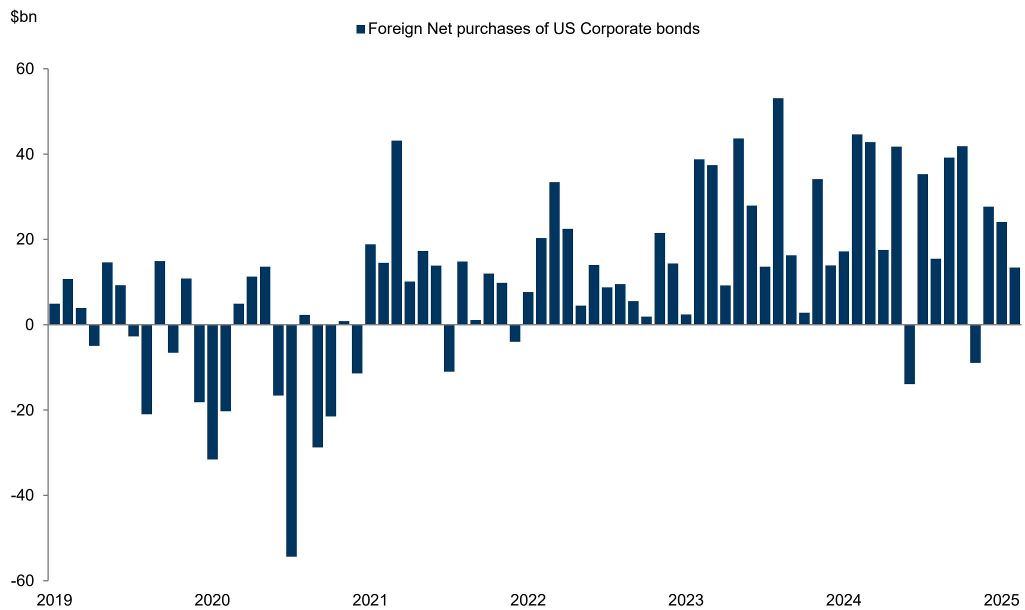
Foreign investors have steadily become a very important source of demand for US corporate bonds, growing from about a 15% ownership share in 2000 to nearly 29% today (Exhibit 1), which is considerably higher than the 18% foreign ownership share of the US equity market. Thus, the risk to valuations from a significant change in foreign participation is not trivial. In contrast to the treasury market, where much of the foreign holdings are held by state entities like governments and central banks, the bulk of foreign demand for USD-denominated corporate credit tends to come from banks, insurance companies, and pension plans, especially from jurisdictions where the yield on local assets is low. In late 2023 we commented on the risk of a drop in demand for dollar-denominated corporate bonds from Japan where a pivot in monetary policy was making yields on local currency assets more competitive with dollar assets. At the time we were dismissive of the threat to demand given the depth and the breadth of US credit markets coupled with the lack of competing domestic alternatives. This view was proven correct as 2024 ended up being a record year for foreign participation in the US corporate bond market.

Exhibit 1: Foreign entities hold nearly 29% of US corporate bonds

Source: Federal Reserve Board, Goldman Sachs Global Investment Research

The gold standard for examining foreign participation is the US Treasury International Capital data (TIC). Exhibit 2 uses monthly TIC data to show that demand for US corporate bonds has been remarkably robust since 2021 with solid inflows almost every month over the last four years. The TIC data suffers from being extremely backward looking, coming out with a six-week lag, thus not yet allowing us to get a read on what foreign participants have been doing since the April 2nd tariff announcement. But as of the end of February, the first full month of the Trump administration, foreign flows were still positive. In order to get a more real-time view of foreign demand we have to come up with more creative measures. Our US portfolio strategists have tried to get at this real time demand by looking at fund flow data from funds that invest in US equities but are domiciled outside the US. In credit we found this metric not to be statistically significant, likely due to the fact that many credit funds are not pure play corporate bond funds.

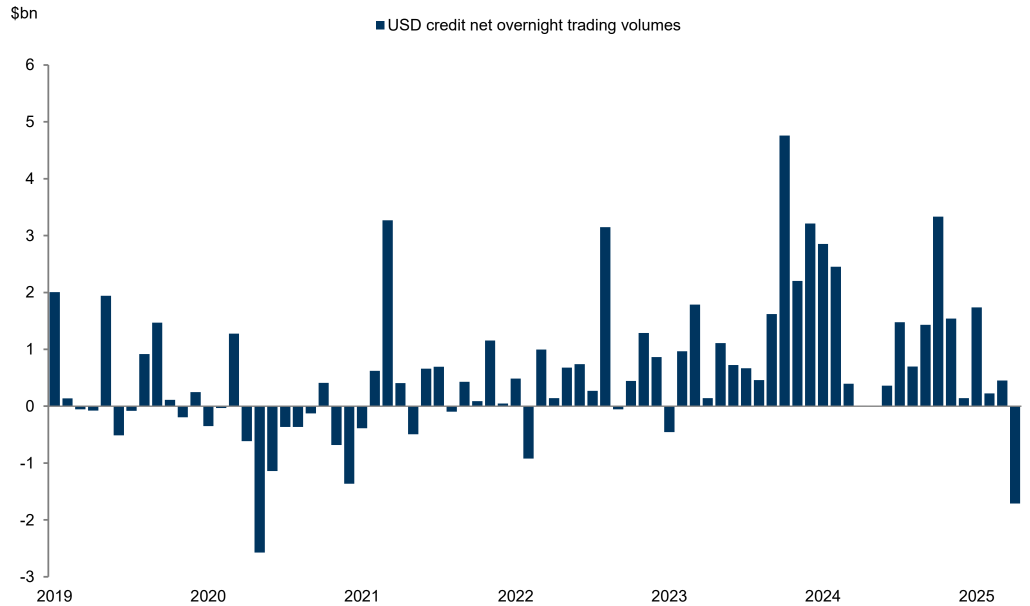
Exhibit 2: Treasury TIC data is extremely backward looking and still showed net inflows as of February
Net purchases of US corporate bonds by foreigners



Source: US Treasury, Goldman Sachs Global Investment Research

Fortunately, trade level data can be used in credit markets as a higher frequency gauge, because all cash bond transactions are required by regulation to be recorded in TRACE within 15 minutes of taking place. Using this TRACE trade level data and then zooming in on trades that occur overnight between the hours of 9pm and 6am EST, we can construct a proxy for direct foreign participation in the USD credit market that updates in real time. Exhibit 3 shows monthly aggregate client buys netted out against client sells from these overnight periods combining both IG and HY trades. The obvious takeaway is that by this metric investors have absolutely been net sellers of USD credit in April, on pace for the highest monthly selling since the COVID period.

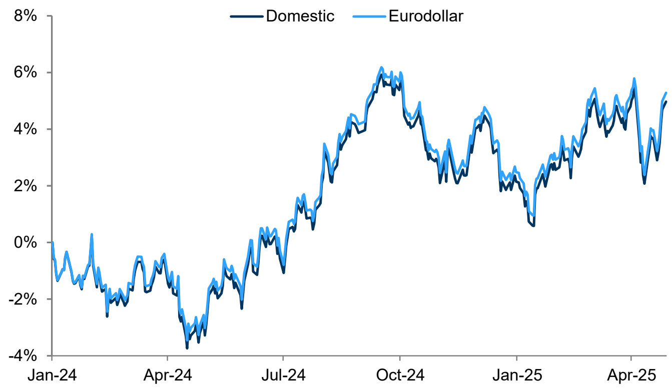
Exhibit 3: Our best real time indicator of foreign demand does show selling pressure in April
Net client purchases of USD bonds (both IG and HY combined) booked overnight between the hours of 9pm and 6am (EST) in TRACE



Source: TRACE, Bloomberg, Goldman Sachs Global Investment Research

Despite the strong net selling we show in Exhibit 3, we would push back against the concern that foreign selling could lead to a flow driven dislocation in US dollar credit, for several reasons. First, our metric is simply a rough proxy for foreign demand but is not a great substitute for the TIC data; most foreign transactions in US credit markets still happen during normal business hours when New York trading is open and liquidity is best. Second, even if Exhibit 3 proves "correct", and there has been significant net selling by foreigners in April, it certainly hasn't yet led to a meaningful widening of credit spreads, which are just 8bp and 21bp wider for IG and HY, respectively, from where they started the month. Third, and in obvious contrast to the treasury market, the USD corporate bond market includes a significant percentage of bonds that are issued by foreign companies. If foreign investors were dumping USD bonds, we would expect that to be tilted toward US domiciled companies and Exhibit 4 shows that just simply isn't the case. US domiciled companies have performed right in line with their foreign peers in the USD IG bond market this year. Given the depth and liquidity of the US credit market and lack of a competing alternative in many places, we still think the bar is high for a meaningful drop in foreign participation.

Exhibit 4: Domestic issuers have performed in line with foreign issuers in the USD market
Cumulative total return for 7-10 year domestic vs. foreign domiciled issuers in the USD IG bond market



Source: iBoxx, Goldman Sachs Global Investment Research

TRADE IDEAS

Best Trade Ideas Across Assets

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1. KRW 2/10Y IRS steepener, opened September 4, 2024, at -12bps, with a target of 30bps, and a stop of -30bps, currently trading at 17bps.
2. Stay long Indonesia 1Y SRBIs fully FX hedged, opened on October 3, 2024, at 6.82%, with a target of 5.70%, and a revised stop of 6.70%, currently trading at 6.48%.
3. Stay short THB/KRW, opened January 10, 2025, at 42.30, with a target of 39.0, and a stop of 44.0, currently trading at 42.87.
4. Receive INR 2Y NDOIS, opened January 28, 2025, at 6.08%, with a revised target of 5.30% and a revised stop of 5.70%, currently trading at 5.50%.
5. NSE India Consumption vs. NSE Infra outperformance pair trade, opened February 03, 2025, at 1.41, with a target of 1.70, and a stop of 1.25, currently trading at 1.29.
6. Receive 5y AUD IRS vs. Pay 5y NZD, opened February 21, 2025, at 0.26, with a target of -0.10, and a stop of 0.26, currently trading at 0.20.
7. Buy SFRZ5 96.25 put vs sell 0QZ5 96.25 put (in net premium), opened March 7, 2025, at -0.03, with a target of 0.12, and a revised stop of 0.00, currently trading at 0.04.
8. Sell 1x2 A/A+17 3m 2s10s curve cap spread, opened March 21, 2025, at 0.00, with a revised target of 0.15, and a revised stop of 0.02, currently trading at 0.06.
9. Pay 2y2y CORRA vs receive 2y2y SOFR, opened April 4, 2025, at -0.98, with a target of -0.65, and a revised stop of -0.9, currently trading at -0.79.
10. Stay long 2Y CGBs, opened April 6, 2025, at 1.47%, with a target of 1.05%, and a

stop of 1.70%, currently trading at 1.46%.

11. Buy 30y TIPS on a beta weighted basis versus nominals (1:0.7x), opened April 17, 2025, at -0.77, with a target of -0.93, and a stop of -0.67, currently trading at -0.79.
12. Stay long BRL/MXN, opened April 17, 2025, at 3.39, with a target of 3.60, and a revised stop of 3.40, currently trading at 3.48.
13. JGB 10s30s flattener, opened April 25, 2025, at 1.36, with a target of 1.10 and a stop of 1.50, currently trading at 1.38.
14. Buy 3-month NOK/SEK 0.9450/0.9700 call spreads, opened April 25, 2025, at a spot level of 0.9282, currently trading at 0.9291.

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Reg AC

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