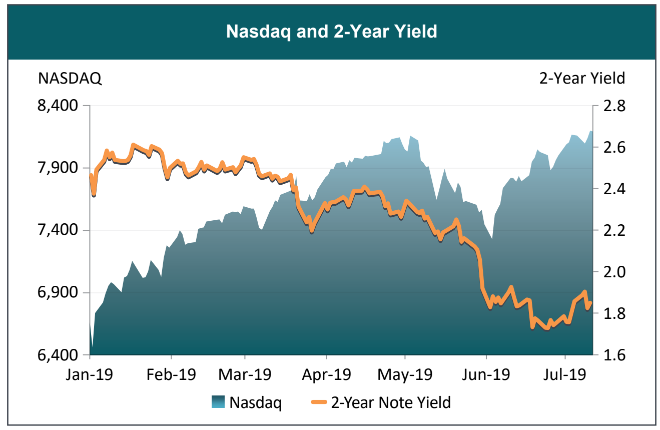
August 2019

The best of times, amid uncertain times



U.S. equity markets are reaching new all-time highs, propelled by strong U.S. consumer data, while employment remains at a 50-year high. While the markets took solace from the trade truce between the U.S. and China at the G20 in Osaka summit, concerns about longer term trade issues remain open. Additionally, softer regional manufacturing data, low inflation and subdued global growth have created uncertainty in the longest U.S. economic expansion in history. Recently, Federal Reserve Chairman Powell mentioned the word "uncertain" 26 times in a Q&A before Congress to describe the economic outlook. U.S. interest rates have been moving lower in response with the 2-year note yield trading at 1.85%, down 45 basis points (bps) since May. With the U.S. interest rate curve inverted between the three-month and 10-year marks, the market is pricing a 25 bps cut from the Fed on July 31 with a chance for two more 25 bps cuts by the end of the year. Fed Chair Powell has affirmed the market's view of a cut in July, but he has not provided further details beyond that. Much of the Fed's outlook will depend on the progress of trade negotiations and global growth. While Fed monetary easing is broadly expected by the market, some analysts are skeptical of the need for a dovish Fed given that U.S. unemployment shows no signs of weakening at 3.70% and equities remain at all-time highs – resulting in a tale of two markets.

Current opportunities and transactions for clients to consider

- **Foreign exchange:** The Dollar is trading near the highs of the year, driven recently by a weaker global growth outlook and trade uncertainties. While the U.S and China have agreed to resume negotiations, a trade deal remains ostensibly in the distant future. The U.S. economy appears to be weathering the economic uncertainty, albeit at a slower growth rate, while Asian and European economies are under more stress. Although the ECB recently left interest rate policy on hold, they have revised forward guidance signaling more rate cuts this year as well the possibility to expand QE. Additionally, the RBA has reduced rates twice this year and is expected to reduce rates again this year. In the U.S., the Fed is expected to cut rates by 25 bps, but recently stronger consumer economic data has reduced the chance for a 50 bps cut. Another tailwind for the Dollar is the recently agreed budget deal that increases spending but more importantly, increases the debt ceiling to 2021, removing the threat of default on the national debt. With the U.S. 10 year note yield trading just over 2%, the increased deficits this deal likely creates appear to be a problem in the future. Looking forward, the Dollar will be driven largely by future Fed policy and trade. The market is pricing nearly three 25 bps Fed cuts this year. As the month of July has shown, there are many open questions about Fed policy, the U.S. economy and trade, creating uncertainties in the market. We can propose different FX solutions and strategies to meet our client's objectives.

- **Interest rates:** Entering the second half of 2019, U.S. employment data continues to indicate sustained health within the labor market while news of trade progress with China sparks optimism that a deal is close to being finalized. Though headlines are positive, volatility continues to influence market yields as uncertainties weigh on the economic outlook. These crosscurrents include, even with the release of positive developments, trade speculation as well as apprehensions about the strength of foreign economies and the possibility that their negative effects could trickle into the global economy. In light of these market influencers and their potential effect on yields, client activity has remained robust as management teams continue to look for ways to mitigate the risk of interest expense uncertainty. More specifically, there have been an increasing number of clients looking to modify their existing hedges in order to take advantage of the current attractive rate environment. These amendments have come in the form of extending the duration of their current hedges in anticipation of future debt or upsizing their hedges to either increase their interest rate protection. Hedging current exposure allows clients to secure their interest exposure at a more favorable rate or to mitigate the impending roll-off of a maturing hedge.

Recent transaction highlights: Best practices and how Citizens creates value

A Multinational Technology Company

Global Markets structured two risk management solutions for a new client, both of which addressed the management team's concerns regarding their interest rate exposure. The hedges consisted of two customized 10-year swaps, one structured on an amortizing (decreasing) schedule and the other on an accreting (increasing) schedule. Overall, the two swaps provided interest expense certainty on $300 million of the client's floating rate exposure. As a result of the education and idea generation that exceeded the client's expectations, Citizens was mandated to lead both transactions and syndicated the financing to various banks of the client's choosing. Furthermore, the client is anticipating to transact a third rate management solution in Q3 2019, on which Citizens is currently providing their advisory services.

A Financial Services Company

Some FX exposures are economic in nature, where a client's financial position in their functional currency is impacted by an FX rate. Other exposures are more mundane: for example, the requirement to deliver foreign currency to pay an invoice. A long-time client in the financial services sector has ongoing needs to deliver complex currencies. One option, of course, is to maintain bank accounts in those countries. However, opening a bank account is already a cumbersome process in the U.S., and can be much more complex in foreign jurisdictions, especially in those countries with capital controls or where the currency is not convertible. In the case of South Korea, Citizens is able to help this client by utilizing our onshore Nostro to deliver local currency without the client needing to have a local bank account. Regulations and requirements vary by currency, but it's generally necessary for clients to provide documentation to support why the payment is being made. Citizens offers a payments service where we can make onshore delivery on behalf of a client in most countries. Typical catalysts for these payments include the local purchase of currency in conjunction with the maturity of a non-deliverable forward (NDF) contract, payments to suppliers or government agencies, and capital or equity injections.

A Community-Focused Nonprofit Organization

Concerned with its impending interest rate exposure given its future debt issuance and the corresponding change to their fixed-to-float debt profile, the client elected to take advantage of the flat yield curve and transacted a two-month forward starting 10-year interest rate swap. With guidance from Global Markets, the swap acted as a portfolio hedge that provided fixed rate protection on 100% of the client's five debt facilities. The client was pleased to secure interest rate protection and ultimately mandated Citizens as lead bank to syndicate the economics of the transaction to peer banks.

Key contributors

Tony Bedikian, Head of Global Markets
Rich Aidala, Head of Sales
Jim Schuler, Managing Director, FX Trading
Nitin Gupta, Director, FX Sales

Getting in touch

Our team regularly sends market commentary and customized updates to current and prospective clients. If you would like more information about current market conditions or details around our Global Markets product offerings, please reach out to the Global Markets desk via 888.821.3600.

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