Global Markets Monthly

Citizens Commercial Banking®

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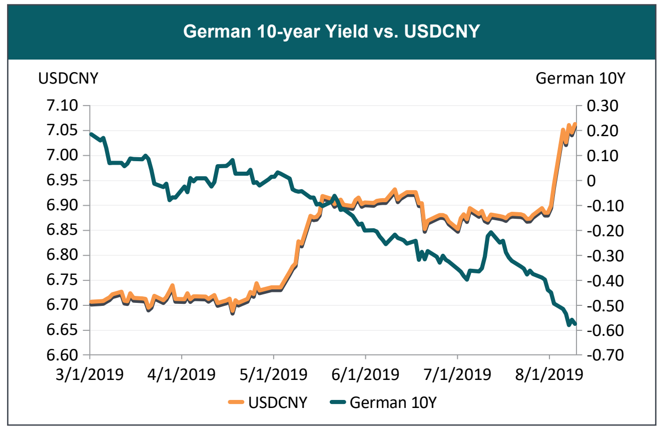
Doves descend over Asia



As the trade war between the U.S. and China drags on, Asian Central Banks are taking action to help aid their economies. Within a period of just three days, the Reserve Bank of New Zealand, along with the central banks of India, Thailand and the Philippines, all aggressively lowered their overnight target rate. Coincidentally, in the same week, USDCNY traded above 7.00 for the first time in a decade after the Trump administration announced an additional planned 10% tariff on sundry Chinese goods. This move above 7.00 is considered an escalation of the U.S.-China trade dispute and contributed to concern that the trade war may lead to a global currency war. The uncertainty surrounding trade and the pessimistic outlook regarding growth is moving investors into the fixed income market, sending yields lower. The German 10-year yield recently dropped to a record low of -61 basis points (bps) intraday, falling 25 bps since the end of June. In the U.S., yields are also trading lower despite a strong labor market and domestic economy. The U.S. 10-year yield is trading below 2% for the first time since 2016. This is in part due to the globalization of interest rates and the importance of Fed policy around the world. Twenty years ago, U.S. interest rates were determined largely by domestic growth and inflation; today, rates are centered around the global macro backdrop. Uncertainties surrounding geopolitical developments have provided support for the US Dollar (USD) despite increasingly dovish expectations from the U.S. Fed, including another planned rate cut in September. The USD will fluctuate on expectations of future Fed rate cuts as well as the oscillation between optimism vs. pessimism on trade and the global growth outlook.

Current market risks and trends for clients to consider

- **Foreign exchange:** The USD has remained strong so far in 2019 as increased geopolitical uncertainties have pushed market participants towards safe-haven assets. As we finish the second half of 2019 and look forward into 2020, it appears as though market uncertainty may persist. For the developed markets, risks include: U.S.-China relations and trade negotiations, economic weakness in Europe resulting in the ECB potentially bringing about lower rates and quantitative easing, political risks in Italy's government and in the UK regarding Brexit, and the currently forecasted two additional Fed rate cuts in 2019. Emerging Market risks surround: China's economic slowdown and the possibility of trade fallout that may negatively impact peripheral Asian countries, political risks in Latin America (Argentina, Mexico and Brazil), and geopolitical risks involving Russia and Turkey. Despite lower U.S. interest rates, these persisting and compounding global uncertainties have reinforced the USD as a safe haven currency. The USD's value is further supported by steady U.S. economic growth in a range of 2.0% - 3.0% against slowing European growth of 1.3%, while forecasts show global growth slowing in 2019 to 3.2% against 3.6% in 2018. While the market is uncertain as to how and when these risks will be resolved, the market could push the USD lower against major foreign currencies should a resolution to global uncertainty materialize as risk-on sentiment develops.

- **Interest rates:** The geopolitical chess match between the world's two largest economies continues to keep market participants on the edge of their seats. Between the recent bout of new tariffs and President Trump's accusation of potential Chinese currency manipulation, trade developments between China and the U.S. have held strong influence on market yields. Taking trade uncertainty and global growth speculation into account, the Fed communicated that these economic headwinds are "threats to what is clearly a favorable outlook" at the July FOMC meeting, where a 25 bps cut was implemented. Fed Chairman Powell framed this ease under the narrative that it was an "insurance cut" given current global headwinds against a strong U.S. economy while stating that the Fed is not at the beginning of a lengthy cutting cycle. Despite this, the market is still pricing in roughly four additional cuts by year-end 2020 and we have seen an increasing number of clients revisit their hedge portfolios to assess where there could be opportunity. Whether it derives from the rate cut lowering borrowing costs or any positive trade developments, stimulus could potentially trickle into the economy sooner than expected and cause the market to recalibrate its easing expectation. With this in mind, clients have elected to either upsize or extend the duration of their current hedges in order to take advantage of the attractive rate environment. Furthermore, whether it is in anticipation of future debt or the impending maturity of existing hedges, clients have also looked to transact forward starting hedges that take effect at a specific future date.

Recent transaction highlights: Best practices and how Citizens creates value

Oil & Energy Distribution Company

Concerned with the July FOMC meeting and in anticipation of an increase in debt, the client communicated their interest in transacting a hedge prior to the Fed rate decision to take advantage of the rate environment at the time. With guidance from the Citizens Global Markets team, the client ultimately executed three new interest rate swaps for three of its subsidiaries, with two of the swaps being amendments to existing hedges. Global Markets was able to lower the companies' respective weighted average interest rates and ensure future administrative efficiencies by transacting single swaps for each entity (one monthly pay-flow, one rate, etc.). The client elected to transact each hedge for seven years to capture the value of the yield curve. The client expressed their appreciation for Global Markets' diligent work in providing interest rate management solutions before the FOMC meeting to avoid any unfavorable risk.

U.S.-based Global Manufacturing Company

As the year-end planning season approaches and the 2020 budgeting process begins, the risk factors discussed above and their impact should be considered when setting foreign exchange budget rates, forecasting future revenue, and margin translation and its potential impact on the capital structure. Shifting global interest rate differentials can still offer an opportunity to hedge with forwards. However, if the risk-on sentiment does materialize, opportunity for better results due to favorable exchange rates (a weaker USD) would be lost.

After a risk discussion with Citizens, a U.S.-based global manufacturing client developed their currency hedge strategy to include optionality in a two-pronged approach. First, the client fixed the floor of their international receivables by executing a strip of participating forwards. This strategy allows for potential upside in 2019 and through 2020 against their budgeted rate. Secondly, the client added strips of forwards and options to minimize the variance they have seen in the hedge program's year-over-year performance. Overall, the inclusion of optionality allowed this client to potentially recoup some of the adverse impacts from the stronger USD in 2019.

Information & Cloud Services Company

Global Markets tailored an interest rate swap for a new client following engaged hedge strategy discussions with the company's management team. Following an analysis of the company's debt profile, Citizens provided a swap structure that increased in size throughout the life of the hedge in order to appropriately address the client's anticipated future draws on debt. The client was pleased with the bespoke interest rate management solution and ultimately mandated Citizens to lead and syndicate the transaction to six participant banks.

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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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