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David Castle's Treasury Notes

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4 minute read.

Adverse weather conditions. Treasury Top Trumps.

I promise not to provide a bi-weekly weather report in this column but the opportunity to again refer to the adverse weather at the time of writing seemed too tempting to pass up as we head into a week of change in the global political scene.

Snow has fallen across much of the UK and while light so far has increased the risk of "black ice" creating unseen slip or skid risk – this could equally be applied to markets as the U.S. Presidential inauguration approaches as does the U.K. Supreme Court ruling on Parliament requirements around Brexit, expected a week later.

The BBC helpfully added to last evenings weather forecast that 30 years ago this week the U.K. was covered in deep snow with temperatures of 8 below Celsius freezing and travel all but shut down. So, they inferred, things aren't so bad after all.

Could they be right for Treasury?

Back in 1987 Ronald Reagan was U.S. President, Margaret Thatcher was re-elected as U.K. Prime Minister for a third term, inflation in the U.S. was 3.66% while in the U.K. it stood at 4.2%.

Meanwhile Federal Reserve interest rates rose from 7.0% to 7.25% then fell to 6.75% and in the U.K the Bank of England rate started at 11% and ended at 8.5% with moves both up and down during the year. In October of 1987 there was a global stock market crash with reports at the time mentioning "after a long period of growth stock markets fell". In the U.S the initial fall was 22.6%, in the U.K. the FTSE was down 26.4% by months' end while in Hong Kong an even more dramatic 45.8% resulted.

Things Have Changed In 30 Years

	1987	Today
U.S. President	Reagan	Trump
U.K. Prime Minister	Thatcher	May
U.K. Base Rate	11%	0.25%
U.S. FED Rate	6.00%	0.75%
U.K. Inflation	4.20%	1.20%
U.S. Inflation	3.66%	1.70%
No.1 Hit Parade	Reet Petite	Rockabye
Popular TV Show	Eastenders	Bake Off*

Source: Google Search (*Dec 16)

One of my son's favourite games is Top Trumps. There seems to be a version of this game for just about anything you can think of, ranging from cars to football stars and animals to, of course, U.S. Presidents.

What might Treasury's Top Trumps be in 2017, and how might we consider these as the thaw sets in next week (apologies for another weather reference!) here we try to pick a few cards that require thought as to how they might be played.

Just as is the case with the implications of Brexit it is not easy to identify which of the stimulus package announcements from the incoming U.S. administration will be implemented, by when and what their short and medium term impact on financial markets might be.

For a liquidity manager responsible for coverage of international clients or balance sheets the mooted tax repatriation plan is aimed at the $2.5 trillion in cash that U.S. corporations reputedly hold overseas. A pre-election plan from the Trump campaign included a tax holiday on re-patriated funds indicating a 10%, rather than 35%, rate would be applied.

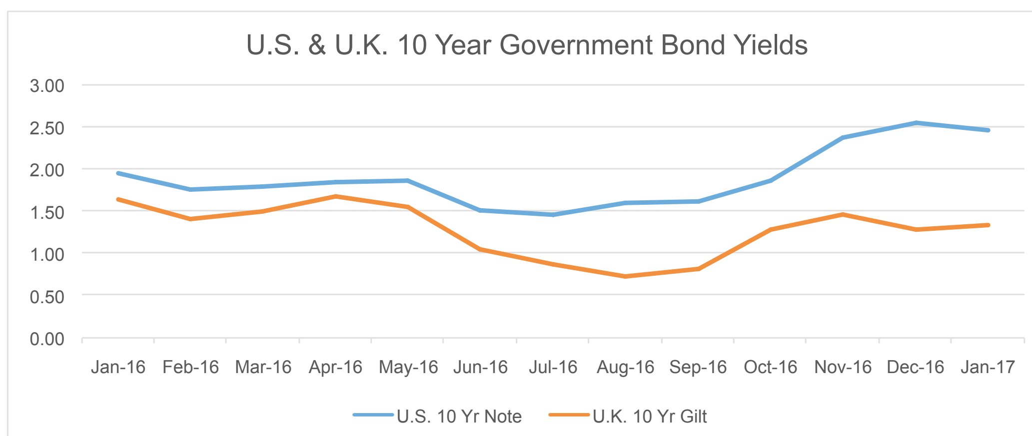
It remains to be seen if this does, in fact, come to pass and it is a topic that has been much discussed over recent years and was also attempted by the Bush administration in 2003. Expectations of the quantum of funds that may flow back range from $200bn to $1trillion – but most commentators suggest that these funds will be used for share buy backs or debt reduction rather than the intended job creation and may also have a marginal effect on corporate bond market issuance.

U.S. Multi-National companies make up a large proportion of the corporate deposit market in many places around the world. Excess cash built up by these entities typically will find its way in deposit accounts, fixed deposits or other money market products managed by a regional treasury centre. The funds most likely to be considered for repatriation would be the "stable" and "strategic" cash pools that are excess to the day to day working capital requirements in a local market.

A substantial change in the investing approach taken by these international companies could further drain the availability of Basel III quality liquidity – longer tenor, more stable, deposits – and exacerbate what is an already more general shortage of $US deposit pools in some markets. Treasury will need to consider how this may impact a funding plan as a further reduction in this part of the liabilities curve would increase deposit market pricing competition and likely point borrowers more toward longer tenor funding options.

Whilst unlikely to be a short term impact as market rates rise and bond markets continue to retrace it will be important to plan ahead in Treasury with a well-structured funding plan that includes capacity considerations should deposit market volumes fall.

10 Year U.S. Treasury Bond yields have increased by 45 basis points over the last six months from 1.80% to 2.45%. While the bond market sell off in December 16 took these yields a little higher than they are today it remains indicative that the several key measures of the longer term funding costs for banks have increased significantly.



Source: Bank of England Data and U.S. Treasury Data

The unseen slip or skid risk that would come with a sharper increase in interest rates in the U.S. or U.K. than is currently expected, coupled with a potential petering out of the "Trump Rally" in global equity markets might not take us into a market like that of 30 years ago and, I'm sure, Treasury is better prepared nowadays.

About the author

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