RPIA

Credit Market Themes in 5 Charts

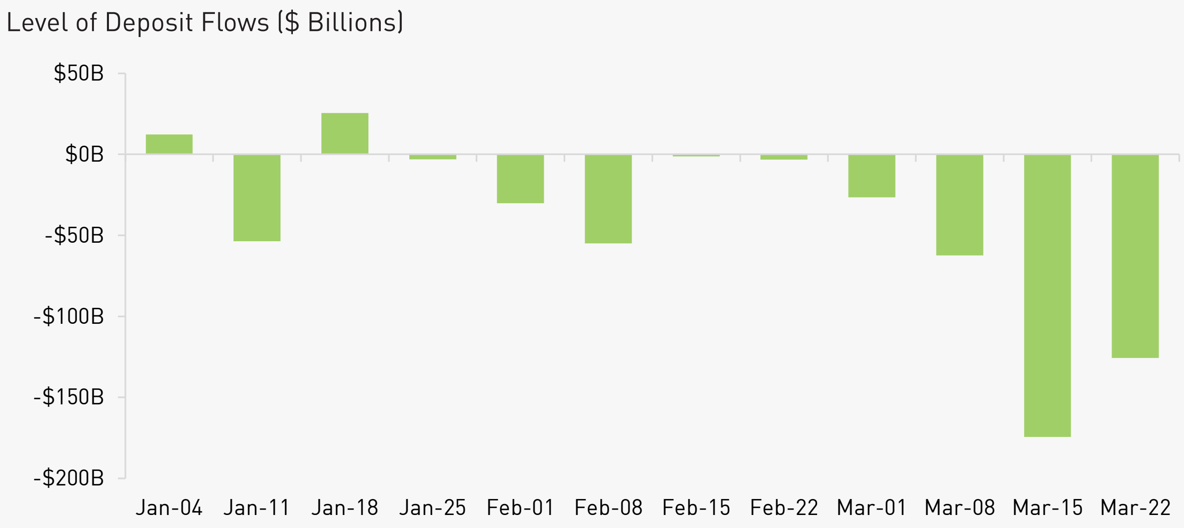
Q1 2023

1 A Flood of Deposit Outflows in March Caused the Collapse of Two Regional Banks in the US

The US Government's response to COVID-19 led to a surge in deposits in the banking system over the past couple years. Banks could not originate loans quickly enough, so instead, they increased their securities portfolios by purchasing interest-rate-sensitive assets.

Some banks did not manage this risk appropriately. Increasing concerns over banks' ability to meet deposit requirements then led to deposit outflows – and what started off as a stream, soon turned into a flood for those institutions with large asset-liability mismatches that needed to sell these securities in the wake of outflows.

Weekly Change in Deposits at US Commercial Banks (2023)

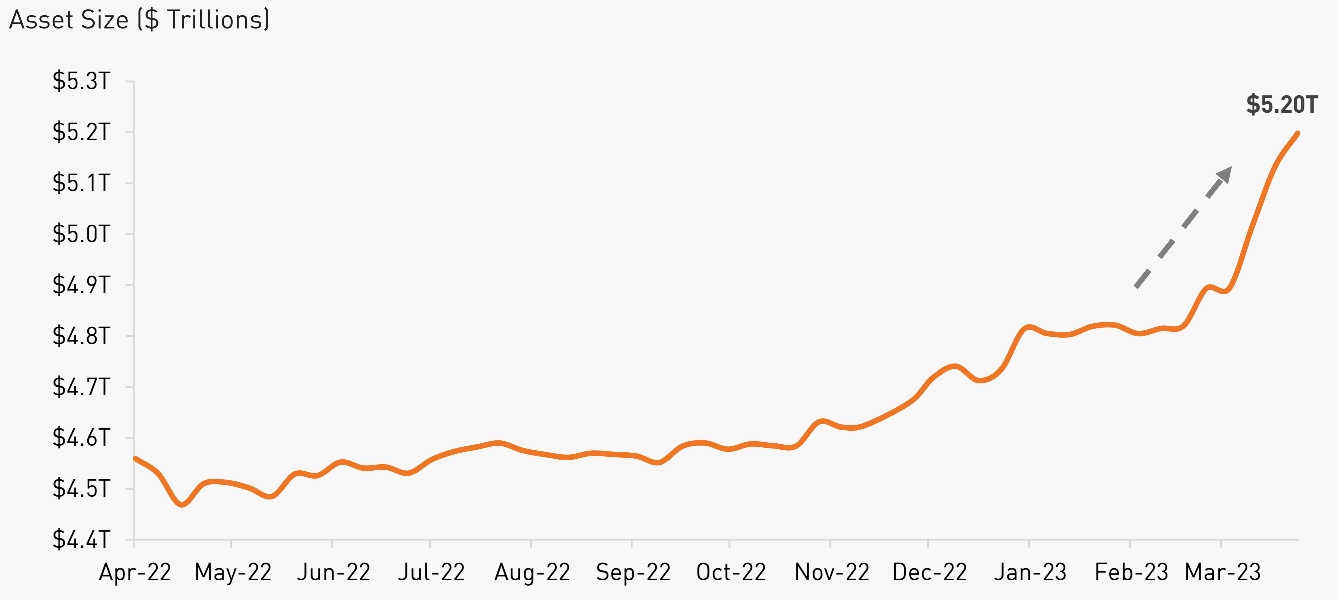


Source: FRED. Data as of 22/03/2023.

2 Large US Banks and Money Market Funds Benefited from Deposits Flow

Year to date, there have been huge inflows into money market funds, with more than $5 trillion parked in these cash-like vehicles. The yield on these funds reset higher immediately in response to higher interest rates, unlike the deposit rates being paid by financial institutions.

US Money Market Mutual Fund Assets - Past 1 Year

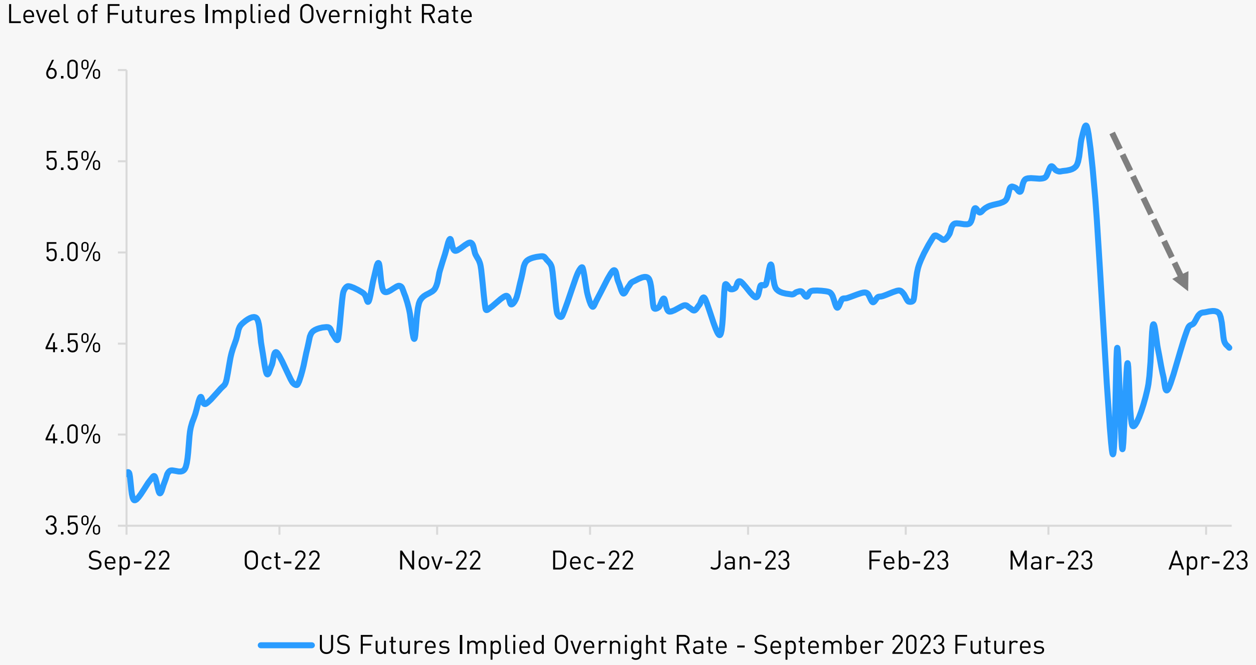


Source: Bloomberg. Data as of 31/03/2023.

3 Global Financial Instability Has Led to a Sharp Decline in Short-Term Interest Rates in March

Investors are rethinking how aggressive the Fed will be with rate hikes following the recent financial turmoil, which has sent short-term yields lower. The 2-year treasury yield dropped 100bps at the beginning of March, marking its largest 3-day decline since the late 1980s.

US Futures Implied Overnight Rate - Past 6 Months

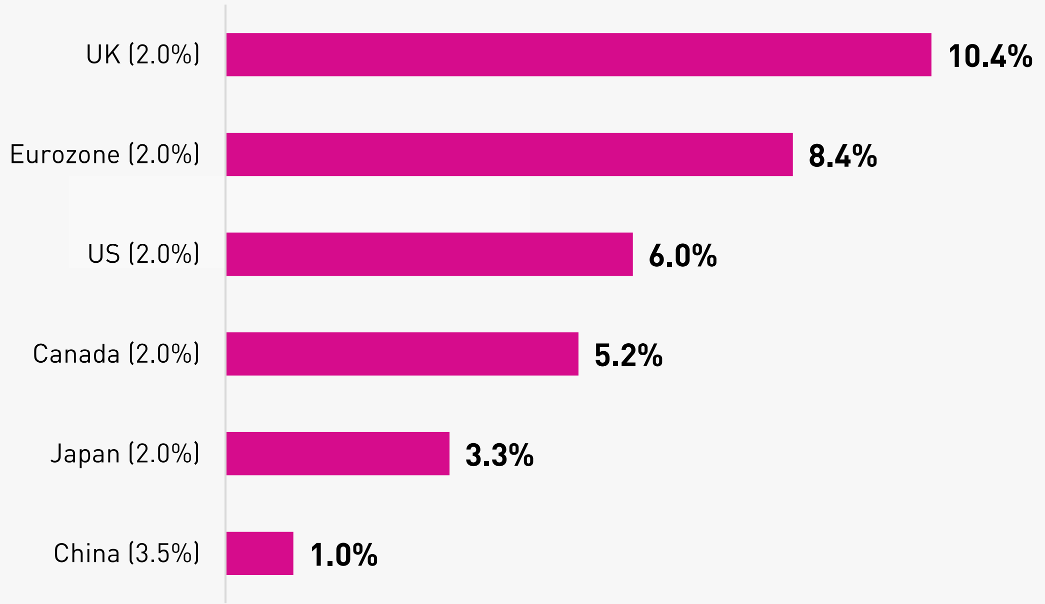


Source: Bloomberg. Data as of 05/04/2023.

4 Inflation Remains Above Target, but Financial Stability Has Taken Centre Stage

The 2% inflation target remains the centerpiece of most central banks' inflation-target frameworks. The recent market volatility has led to debates on whether central banks should raise their inflation targets to prevent a potential recession.

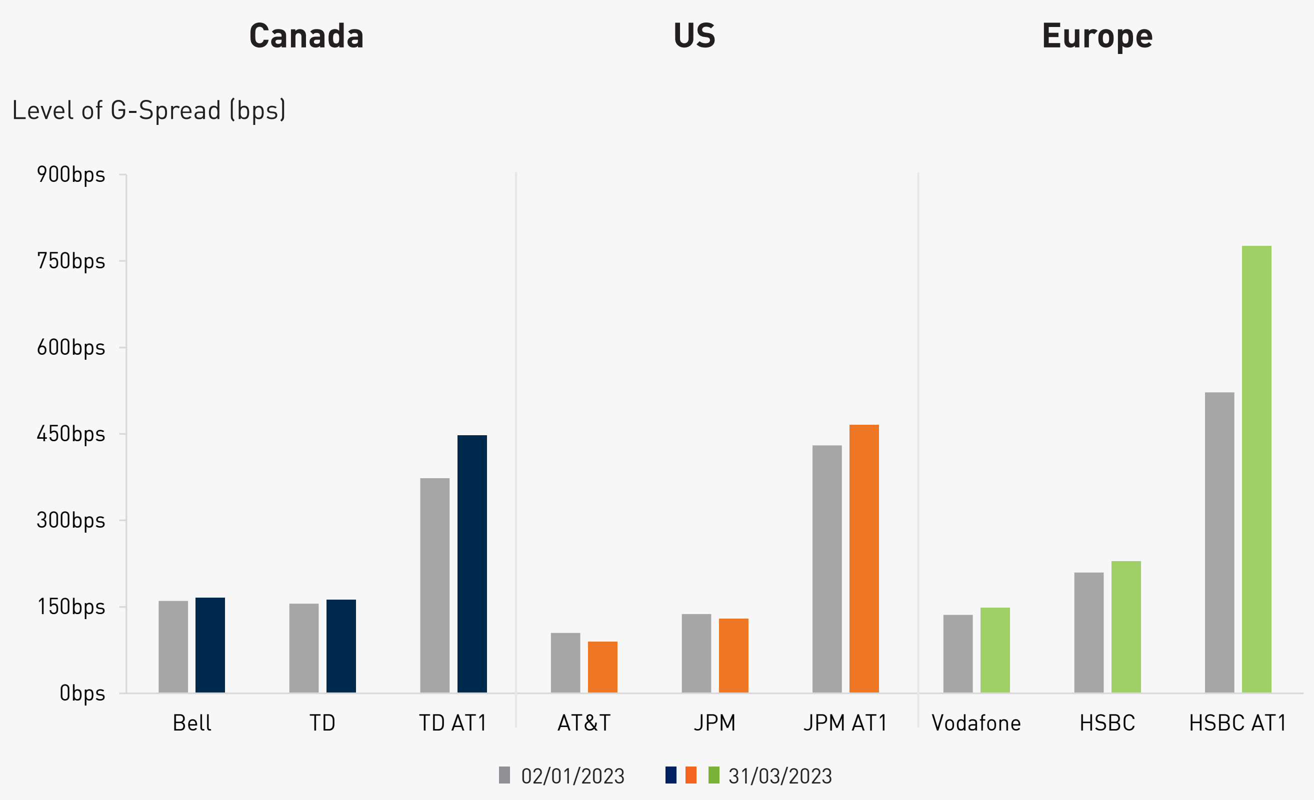
Central Bank Inflation Target (shown in parentheses) vs. CPI Inflation



Source: Bloomberg. Data as of 28/02/2023.

5 Credit Spreads Have Widened Across the Board – Especially Subordinated European Debt Instruments

European financials have seen greater levels of discount compared to their North American counterparts with the most notable example being the Additional Tier 1 (AT1) bonds.



Source: Bloomberg Barclays. Data as of 31/03/2023. G-Spread refers to the difference in yield between a corporate bond vs. a government bond of similar maturity and credit quality.

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