FINANCIAL TIMES

November 17, 2015 9:49 am

US bond dealers hold net negative positions for the first time

Joe Rennison and Eric Platt in New York

Official figures reveal that bond dealers in the US are for the first time in aggregate holding net negative positions of company debt with a maturity longer than a year.

Corporate bond inventories have been in decline for some time, with analysts pointing to the higher cost of capital as a constraint on banks' balance sheets.

What are negative inventories?

Every week the Federal Reserve Bank of New York collects data from the 22 US primary dealers — institutions responsible for underwriting the government's debt. All long (bought) positions and all short (sold) positions at each dealer are aggregated to derive one figure, which represents the net position of all the banks combined.

The data survey only the primary-dealer entities, which may be separate from other activities of the banks, especially large foreign ones.

For the week ending October 28, primary dealers held a net $1.5bn of corporate investment-grade debt maturing in less than 13 months; $3bn of debt between 13 months and five years; minus $3.1bn for five to 10 years; and minus $1.25bn for debt longer than 10 years.

Beyond a year the net figure was therefore negative.

Dealer inventories of IG bonds that mature in at least a year have rebounded to a positive $3.67bn, although the five-year to 10-year segment continues to be negative at minus $1.1bn, continuing a trend from mid-October.

How does this relate to the corporate bond market?

Typically as year-end approaches the liquidity in secondary bond markets deteriorates. Investors have usually made their returns for the year and start reducing their positions, while banks clean balance sheets for financial year reporting requirements used to determine capital requirements.

Jeffrey Meli, a strategist with Barclays, says volatility has probably discouraged dealers from taking "outsized directional risks" or being overly short or long.

Does the net negative position reflect shrinking bank balance sheets?

Technically the information says nothing about the size of banks' corporate bond portfolios because the figure reported is net rather than gross.

The gross number could have dramatically increased, suggesting an increase in banks' balance sheets, but at the same time the net figure could have fallen or stayed the same.

Strategists with JPMorgan, one of the primary dealers, note that the positioning of the bank's high-grade bond trading desk "did not differ substantially from the average net position year to date, and the desk is usually long bonds".

Mr Meli says: "The incentive for dealers to offset their cash longs with cash shorts has increased throughout 2015 and is significantly higher than it was before the credit crisis."

Is this related to corporate bond issuance?

Some investors reacted to the news of negative inventories at primary dealers by saying it was to be expected considering the flood of new bonds on to the market, with companies rushing to issue before the US Federal Reserve raises interest rates.

Often dealers buy credit derivatives on a company before it issues debt. Buying credit protection is equivalent to a short position, or selling the company's bonds. By doing this the bank is able to buy more of the debt when the company issues, supporting its price in the secondary market.

But the number reported to the New York Fed does not include derivatives trades.

Mr Meli notes that derivative volumes are in decline and have become less of an effective hedge, and infers that dealers are instead selling bonds to offset long positions.