

# Macroeconomic Update & Commercial Paper Overview

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# Overview & Objectives

- Provide a macroeconomic overview and thoughts on the risks of the next recession
- Understand the mechanics and risk profile of commercial paper

# Is a Recession Coming?

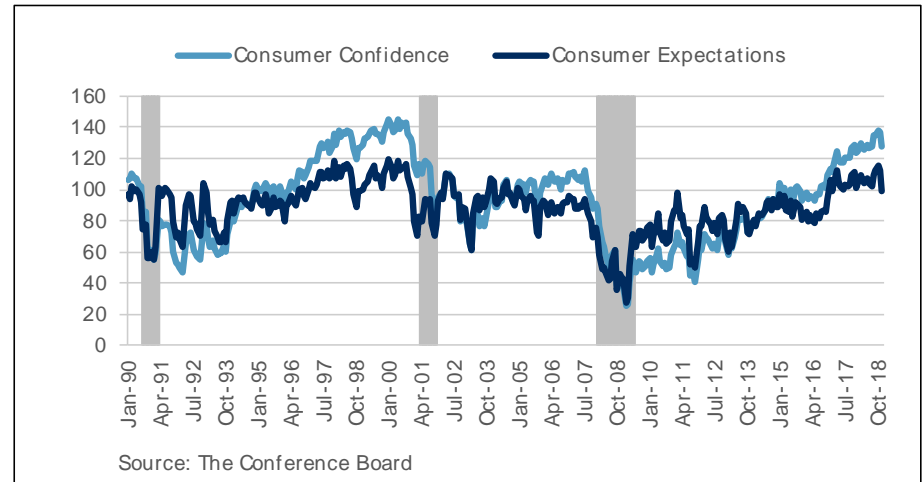
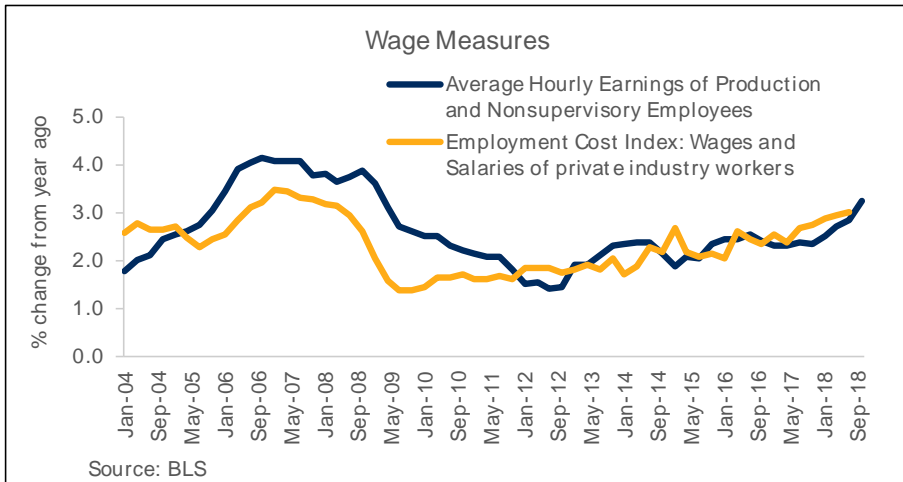
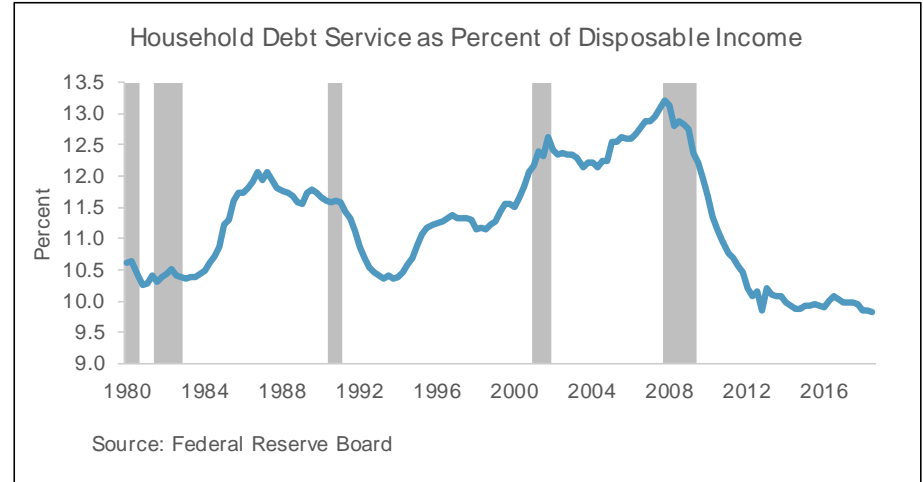
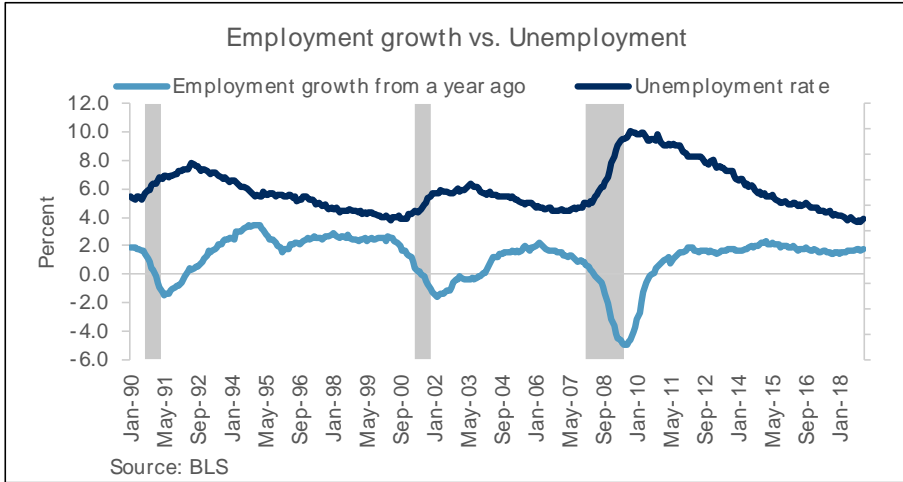
## Maybe Yes

- Business investment slowdown
- Housing sluggishness continues
- Overseas uncertainty
- Fiscal boost fading and monetary policy tightening

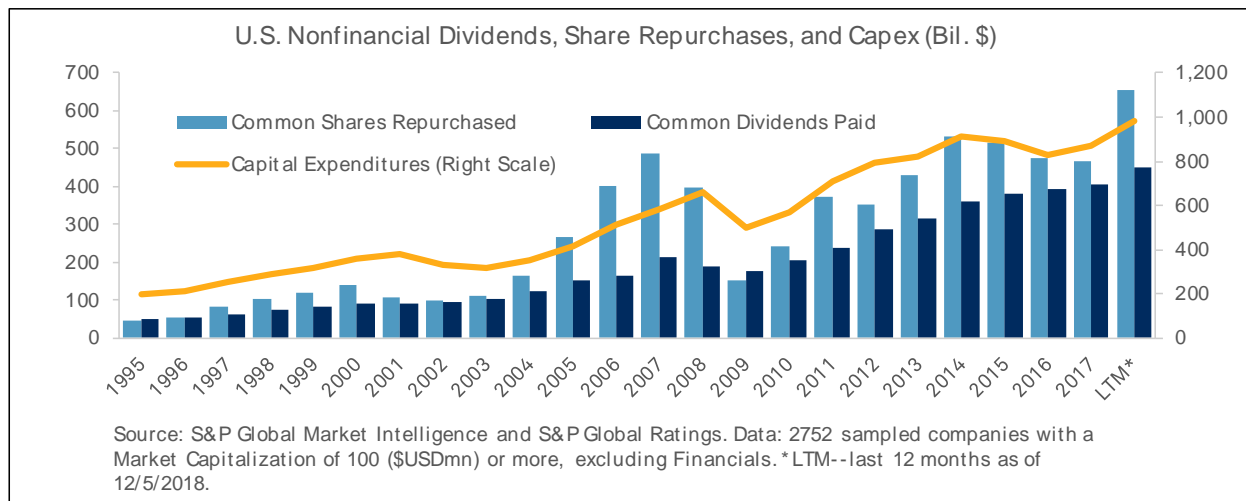
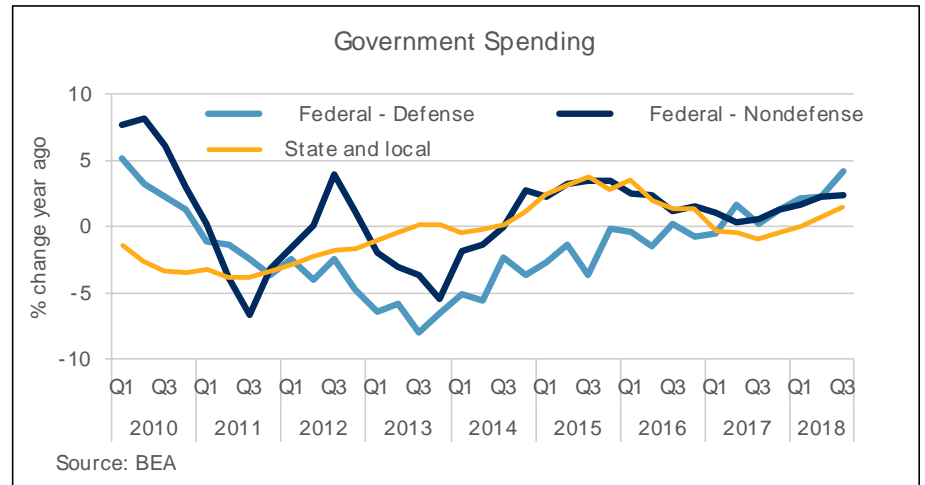
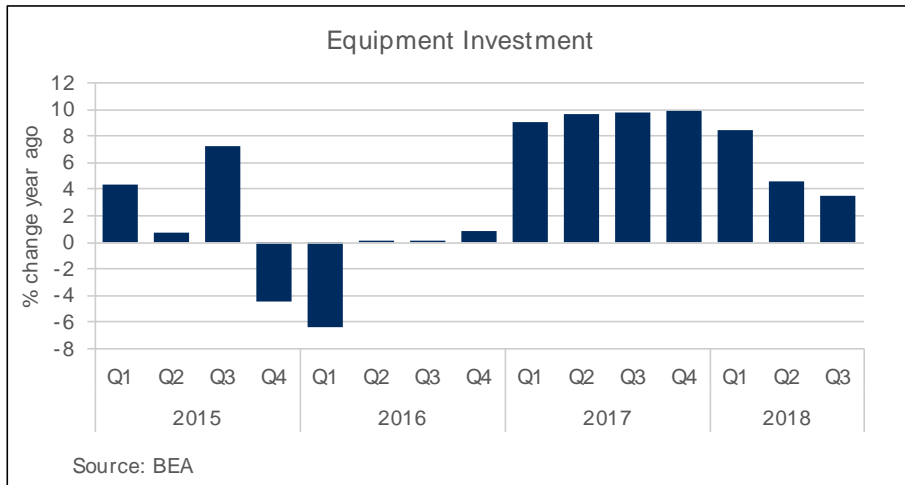
## Maybe No

- Strong labor market and personal income growth
- Solid consumer spending

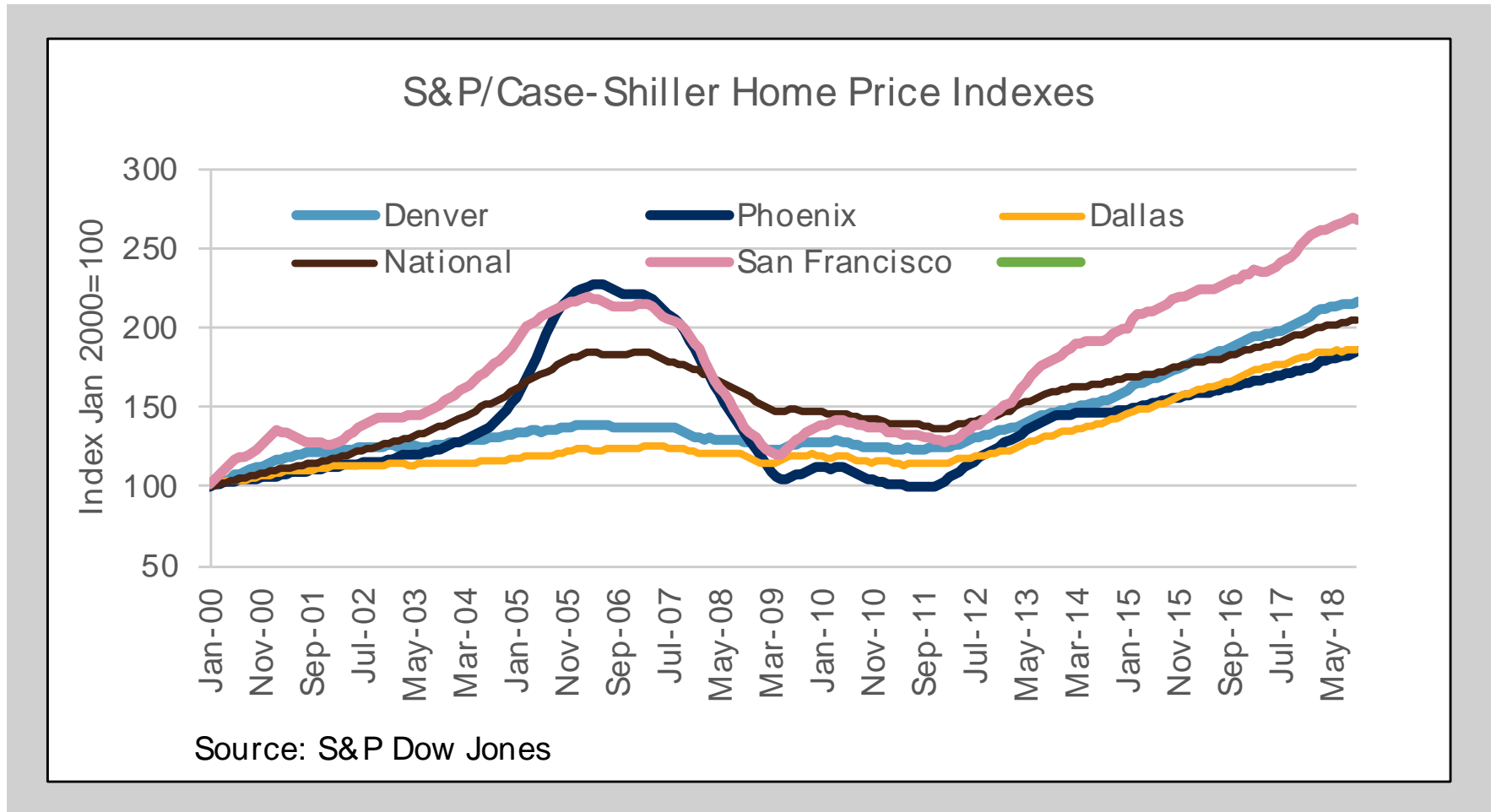
# The State of the U.S. Consumer



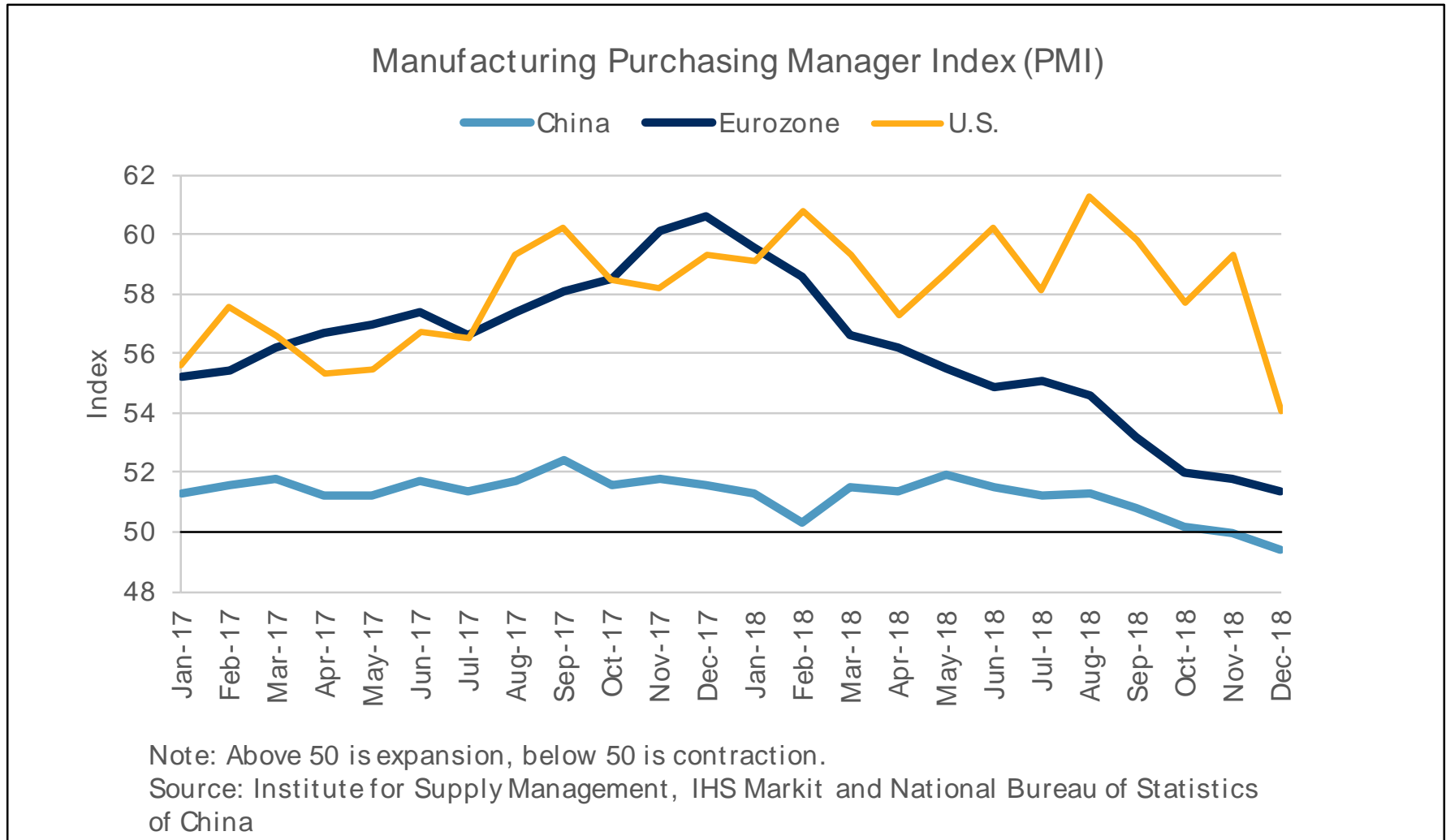
# Corporate and Government Spending



# The State of the Housing Market

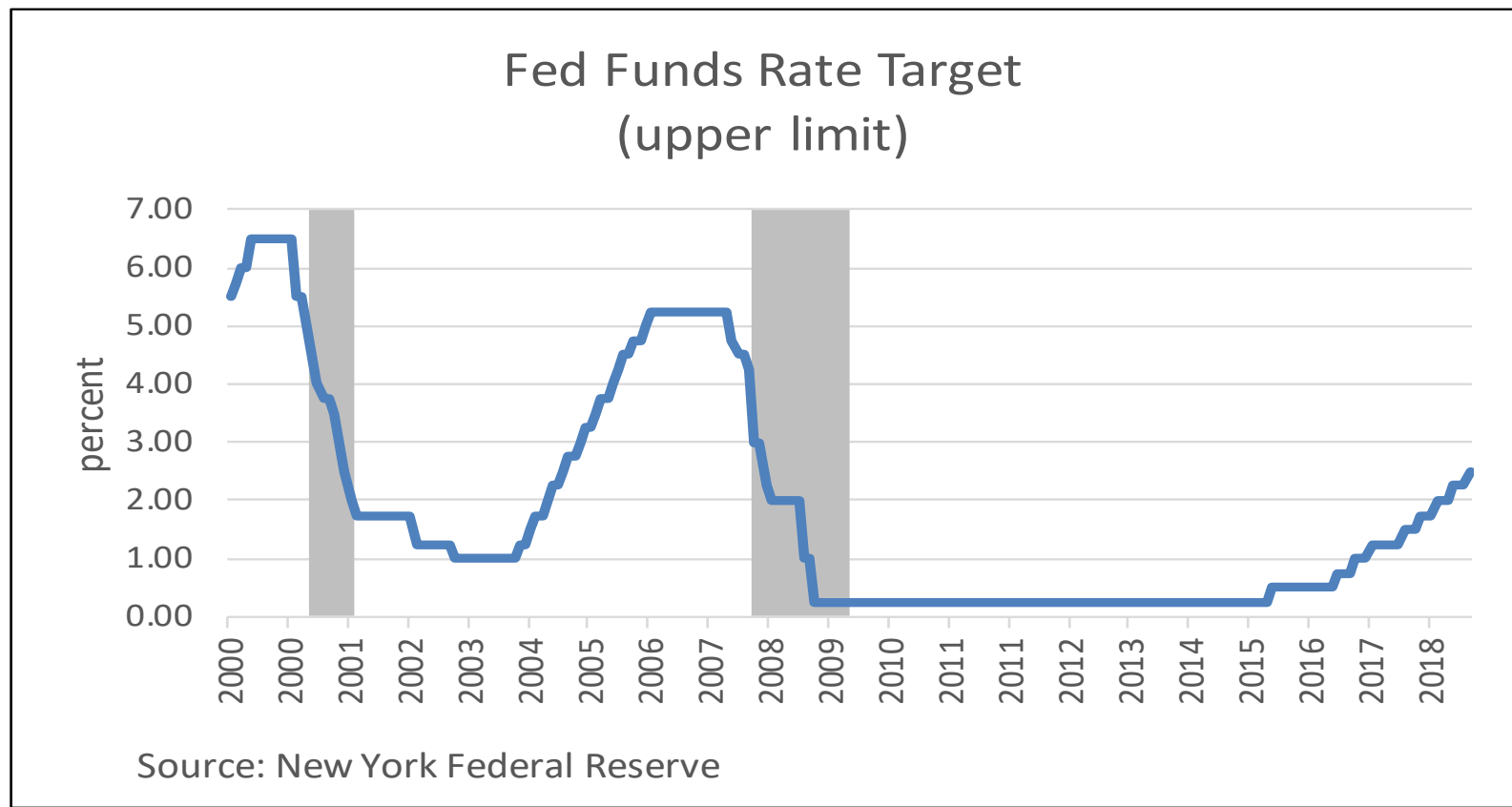


# Global Manufacturing



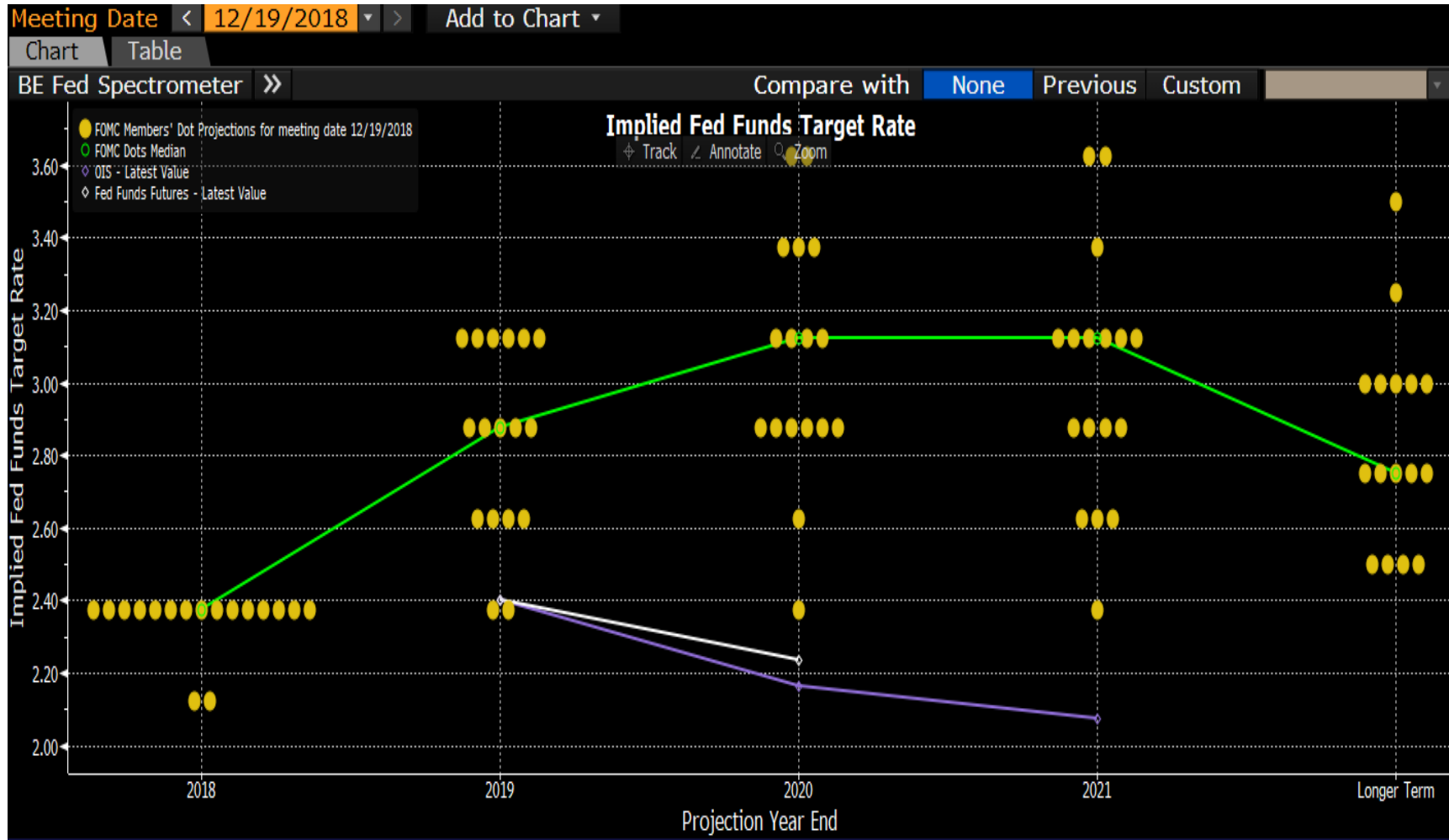
# The U.S. Monetary Path is More Uncertain

- ☰ The Fed is nearing its estimate of the neutral rate of 2.5%-3.0%
- ☰ The Fed is 'data dependent'





# The Federal Reserve Dot Plot



# The Economic Expansion is Mature

		Number of months			
Peak	Trough	Expansion (trough to peak)	Recession (peak to trough)	Peak to peak	Trough to trough
Current cycle -???		116 as of Feb			
December 2007	June 2009	73	18	81	91
March 2001	November 2001	120	8	128	128
July 1990	March 1991	92	8	108	100
July 1981	November 1982	12	16	18	28
January 1980	July 1980	58	6	74	64
November 1973	March 1975	36	16	47	52
December 1969	November 1970	106	11	116	117
April 1960	February 1961	24	10	32	34
August 1957	April 1958	39	8	49	47
July 1953	May 1954	45	10	56	55
November 1948	October 1949	37	11	45	48
	<u>Average</u>	<u>58</u>	<u>11</u>	<u>69</u>	<u>69</u>

Source: National Bureau of Economic Research (NBER) and S&P Global Ratings, Jan. 15, 2019

# What Could Stop the Expansion?

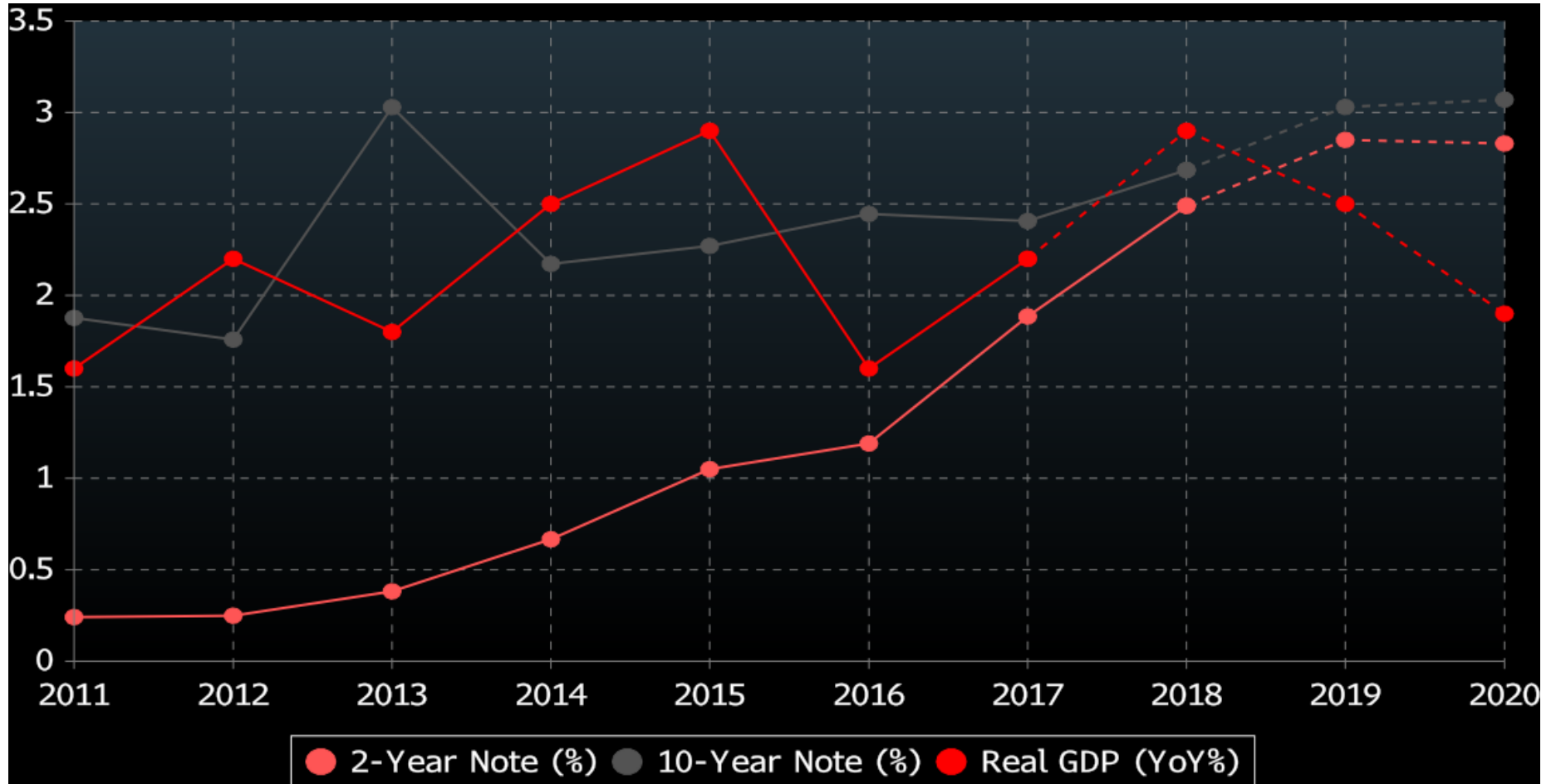
## Possible Scenarios

- Monetary policy
- Government policy/political risk
- Trade/investment protectionist policies
- Asset market declines/volatility
- Global growth concerns

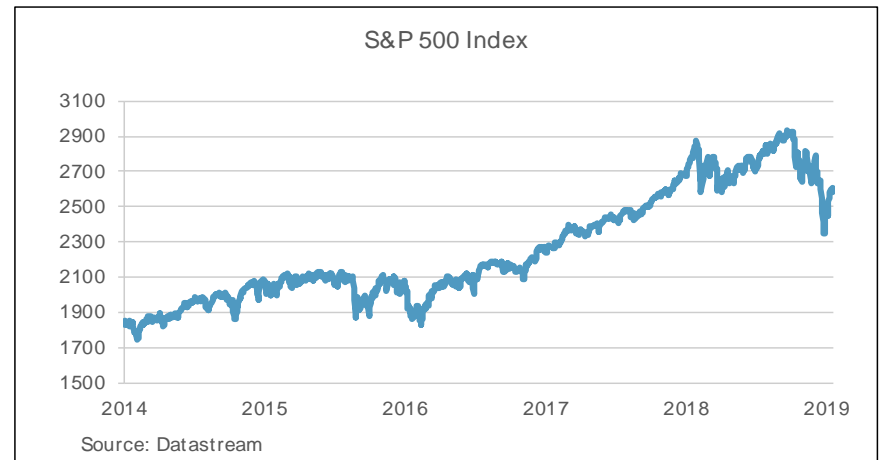
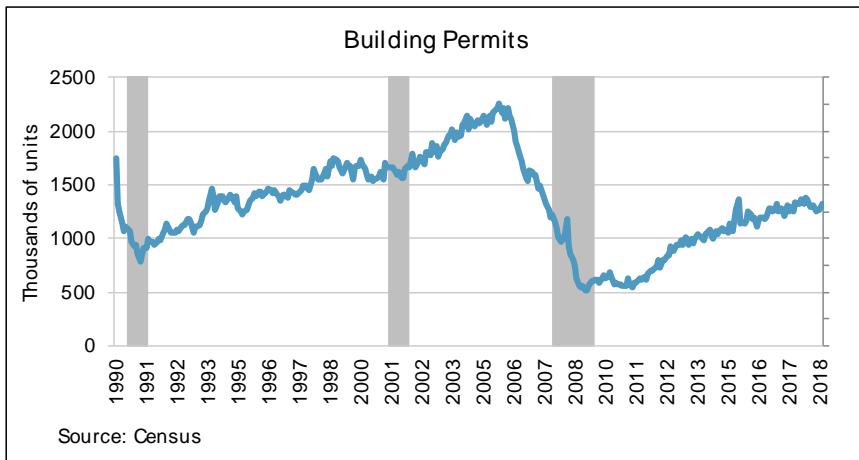
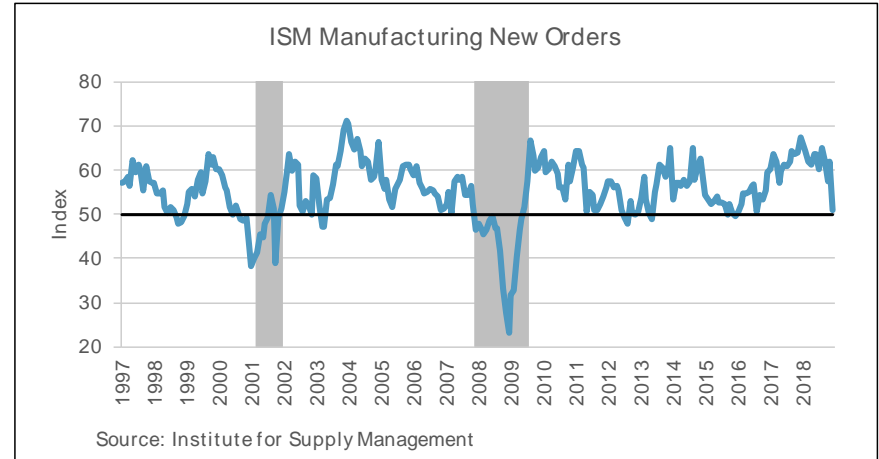
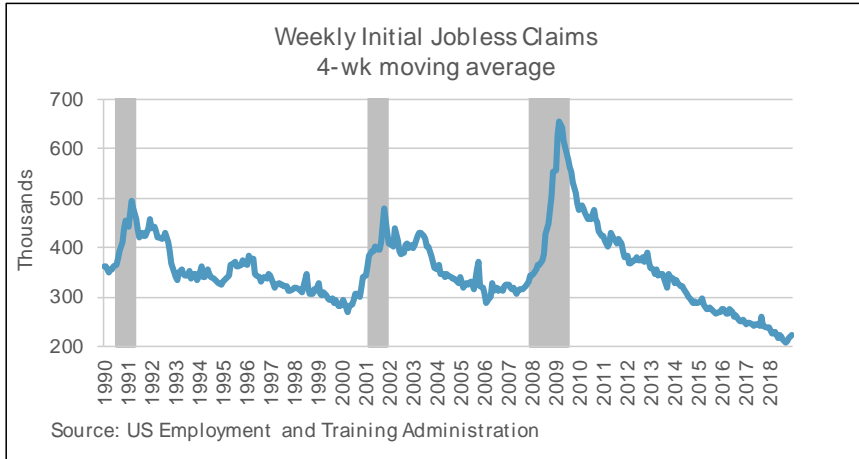
## Leading Indicators

- Housing starts/building permits
- ISM manufacturing
- S&P 500 Index
- Consumer sentiment
- Jobless claims
- Yield curve

# 2-Year/10-Year Yields



# Other Leading Indicators: Flat to Slightly Softer



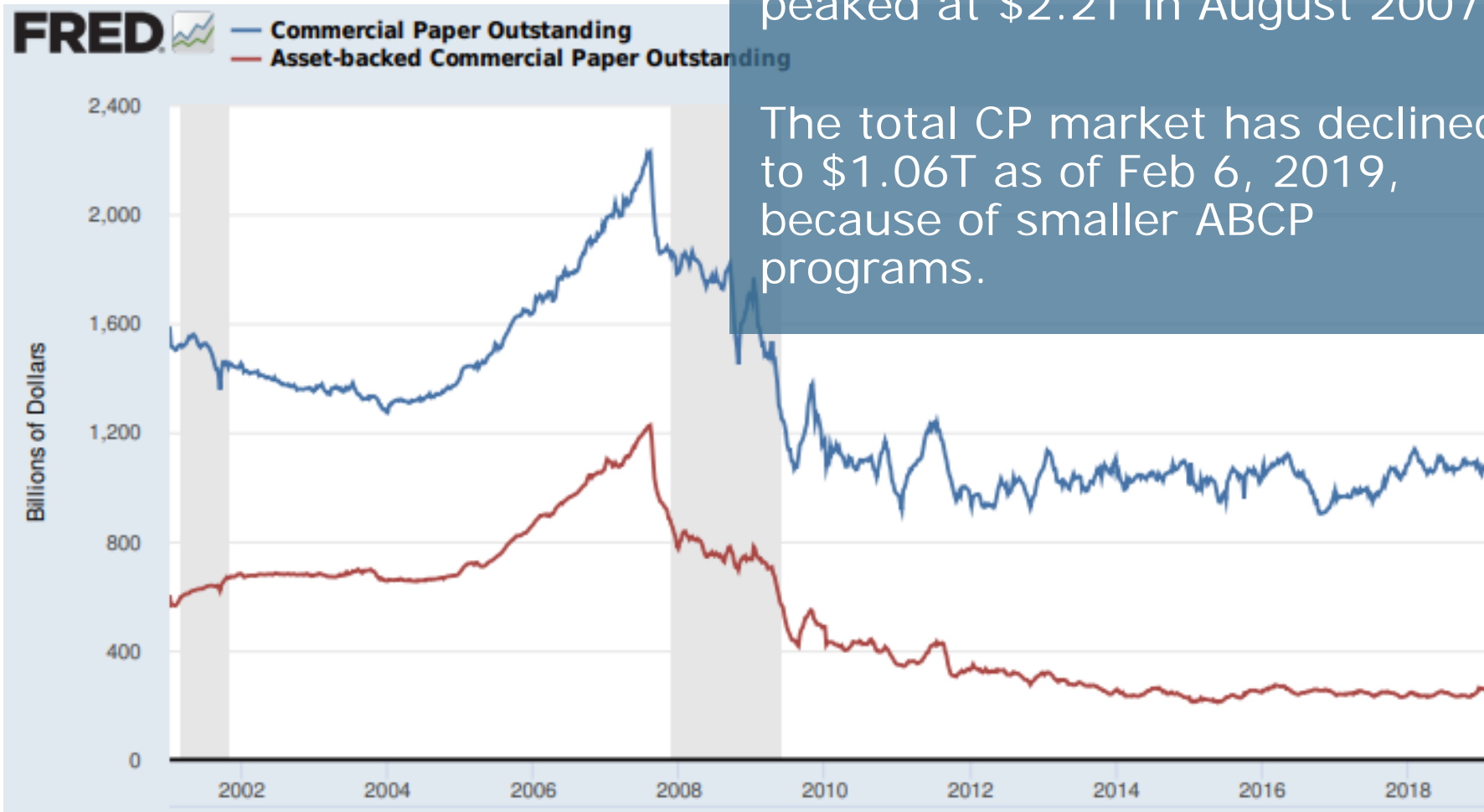
# Is a Recession Coming?

- ❏ Yes, but not right around the corner.
- ❏ Slowdown in the U.S. economy is the base case outlook.
- ❏ Some risk already present; some are amplifying.
- ❏ Leading indicators suggest too early to tell.
- ❏ Indicating data is widely available.

# Total Commercial Paper (CP) Outstanding

Total commercial paper market peaked at \$2.2T in August 2007.

The total CP market has declined to \$1.06T as of Feb 6, 2019, because of smaller ABCP programs.



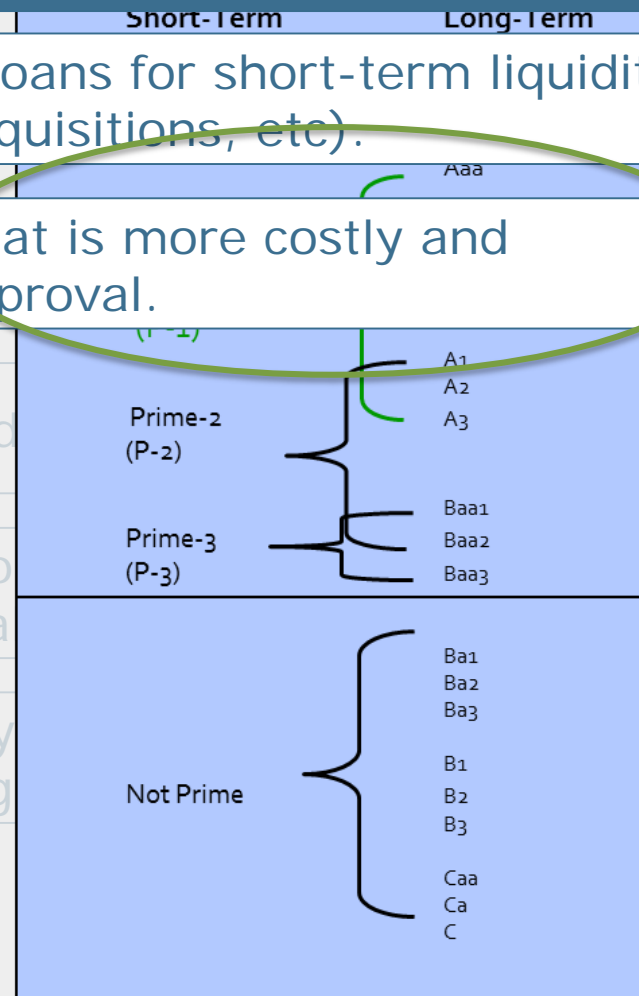
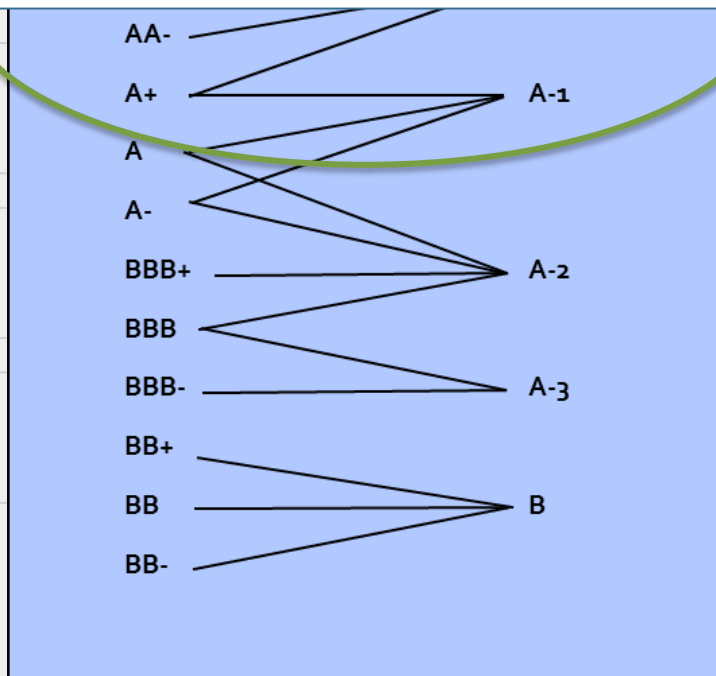
Source: Board of Governors of the Federal Reserve System (US), Commercial Paper Outstanding, retrieved from FRED, Feb. 12, 2019

# An Overview of Commercial Paper (CP)

## Why?

Low-cost financing alternative to bank loans for short-term liquidity needs (working capital, acquisitions, etc).

Exempt from SEC registration that is more costly and takes time for approval.

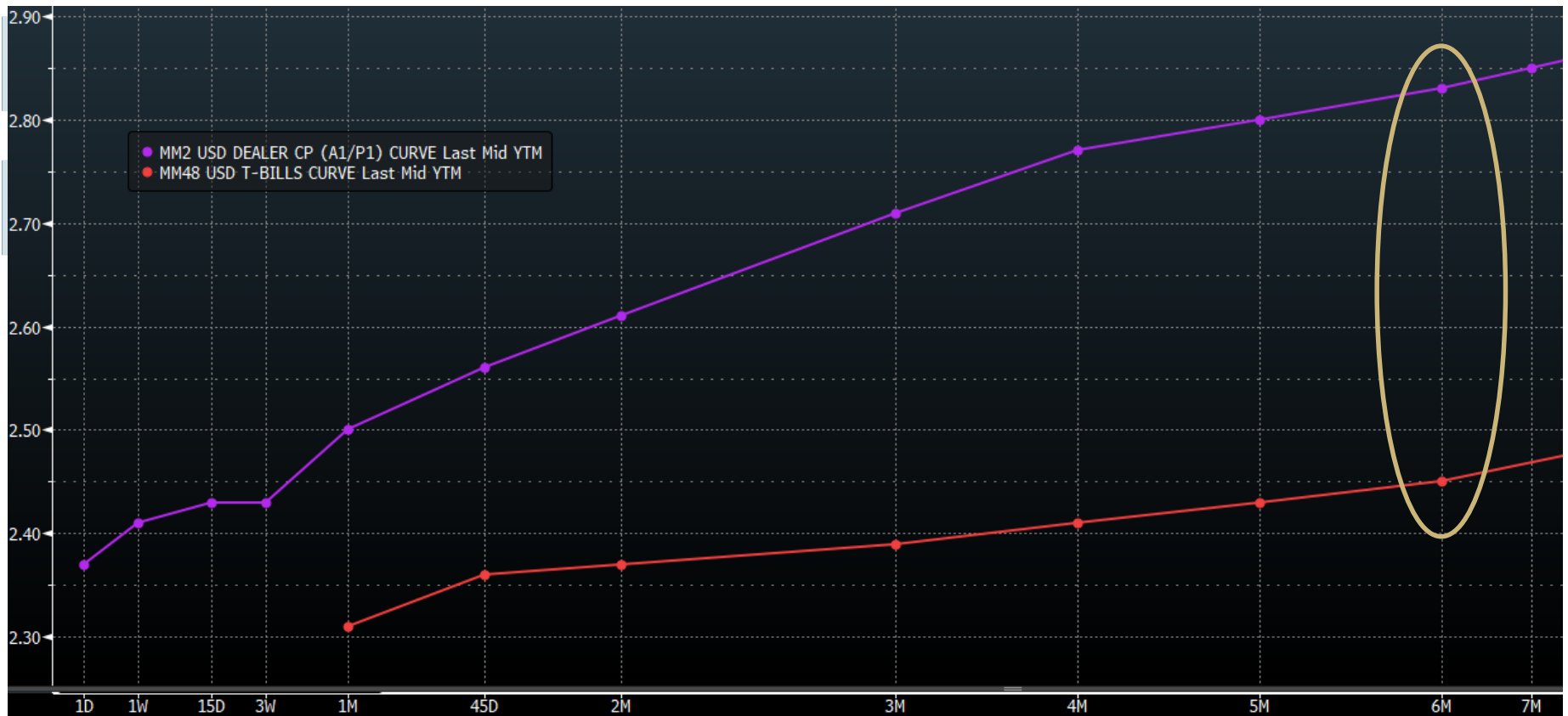




# Why do Investors Like CP?

## Safety

Only high-grade issuers have CP programs and are backstopped by a revolving bank facility.



# How Does the Credit Team Evaluate CP?

- ❏ CP is backed by the full faith and credit of the issuer. The issuer is the focus of the analysis.
- ❏ Evaluate the cash flows and profitability.

## Resources

Public filings

Market data

News headlines

Investor relations

Industry research

NRSRO research/analysts

Sell-side research

Earnings calls/transcripts

Analyst days/conferences

# Commercial Paper Rating Example: PepsiCo

- Below is an assessment of Pepsi's CP (short-term) ratings as presented to the Credit Committee.
- Short-term ratings are "notched" off of the corporate credit rating.

## Ratings Migration Assessment

### S&P Outlook triggers:

**Upgrade-** leverage sustained below 2x, net debt would have to decline by more than \$6 billion

**Downgrade-** EBITDA to weaken resulting in leverage of about 3x, no debt financed acquisition or share repurchases of more than \$6.5 billion.

The most likely path for a downgrade would be a shift in financial policy where the company would issue more than \$6.5 billion of debt to support further aggressive shareholder returns or a sizeable acquisition. CP/Short-term rating is safe even with a one notch downgrade from A+ to A; both result in an A-1 score.

Pepsi doesn't do acquisitions as often as Coke and the acquisition announcement of SodaStream was viewed as a unique asset outside of Pepsi's informal 'no more than \$500M of acquisitions per year' policy. Pepsi has been growing its dividend so the likelihood of leveraging up with debt to solely fund more shareholder returns is unlikely over the next year.

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