Trade Around the World: Optimizing Working Capital in a Rising U.S. Interest Rate Environment

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When the going gets tough, the tough get going. This is the way many corporates are feeling these days as interest rates rise in the U.S. and global liquidity also begins to tighten.

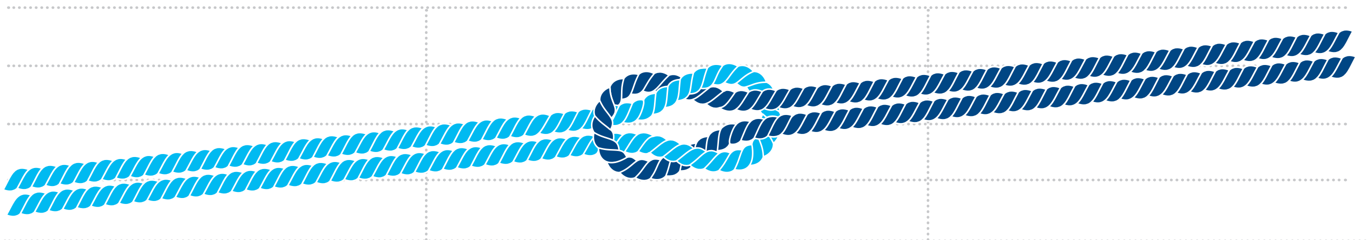
In this challenging environment, it is important for corporate treasury operations to be in top shape in order to seek potential pockets of liquidity and find new ways to extend working capital. The diet: centralizing operations, digitizing manual processes and leveraging new financing structures which can help offset risk and drive growth globally.

Switching into High Gear in Tightening U.S. Markets
Like marathon runners training in higher altitudes, multinationals should consider adjusting their strategies to thrive in the rising interest rate environment. And this is just the starting line.

In the U.S., the Fed has already raised rates three times in 2018, and has indicated more increases before the year is over. Since beginning to unwind its balance sheet in October 2017, the Fed's total assets have been reduced by more than $250 billion. Projections for the Fed's continued unwind from September 2018 through the end of 2019 are expected to total $750 billion[1]. This post-crisis shift from quantitative easing to quantitative tightening comes through a reduction of central bank asset purchases which can result in less liquidity in the market.

[1] *Federal Reserve website*

Liquidity Tightens as Interest Rates Rise



1. Pulling back: *projections for the Fed's continued unwind from September 2018 through the end of 2019 are expected to total $750 billion*[1]

[1]Federal Reserve website

2. Rippling effect abroad: *rate expectations for G-7 Central Banks, including the U.S., Eurozone, UK and Canada are predicted to rise through 2020.*

3. Warning Signs: *the LIBOR-OIS spread has seen a sharp rise in the first half of 2018. During this time, it widened to nearly 60 basis points (bps), which represents levels not seen since 2008.*

The writing is on the wall with key indicators as well. The tightening of liquidity and the growing impact of higher borrowing costs is clearly reflected by the widening of the LIBOR/OIS spread. LIBOR, the benchmark rate that many of the world's leading banks charge each other for short-term loans, has seen a sharp rise in the first half of 2018. During this time, the LIBOR-OIS spread has widened to nearly 60 basis points (bps), which represents levels not seen since 2008.

Emerging Markets Also Feeling the Capital Crunch
Along with the tightening U.S. market, a rippling effect can be felt abroad. Rate expectations for G-7 Central Banks, including the U.S., Eurozone, UK and Canada are predicted to rise through 2020. While 2017 was a banner year of growth for emerging markets, Bloomberg predicts that the availability of funding for suppliers, particularly emerging market suppliers, will be increasingly challenging this year. These markets are already feeling the burden of the loss of liquidity as the dollar supply contracts. Dollar funding that flooded emerging markets following the economic crisis is now subsiding, which means global buyers and suppliers alike will be impacted. Solutions like Citi® Supply Chain Finance can help allow corporates to leverage the strength of their credit profile to mitigate the stress on emerging market suppliers.

In this increasingly tight environment, more and more corporates in the U.S. and especially multinationals who may also be impacted globally are seeking to adjust their strategies to help stretch working capital. As corporate borrowing costs rise, treasury and finance departments often are compelled to seek out innovative methods and more structured financing to optimize free cash flow to reduce debt and lower the interest rate burden.

Supply Chain Finance Adapting with the Markets
Supply Chain Finance is a key area for innovation since it is closely linked with payments and fintechs. With increased costs of borrowing as a result of higher interest rates, corporates are looking to optimize working capital by extending the time to pay invoices and accelerating the repayment timeline on receivables.

Citi® Supplier Finance is now being offered with Citi's WorldLink® Payment Services (WorldLink), which can help corporates further streamline their costs and complexity involved in making payments to suppliers around the world in their local currency. Through a single point of implementation, clients can potentially access these two recognized strategies, where, in certain markets, they can issue payments in more than 120 currencies, making cross-border payments simple and secure with reduced implementation headaches and FX markup fees.

In a world where data is king, Citi Supplier Finance, now with WorldLink, also enables both buyers and suppliers to onboard faster and have access to all their invoicing documents electronically. This helps increase transparency in order to help eliminate the need for multiple foreign currency accounts and idle balances while helping decrease exposure to currency devaluation and foreign exchange risk – a key focus area especially in today's rising interest rate market.

Reducing Exposure with Structured Strategies Like Sales Finance
Beyond foreign exchange, multinationals based in the U.S. or that have entities in the States may feel the effects of the liquidity changes more, especially as they are doing business with suppliers in the tightening credit conditions of emerging markets. Risk mitigation tools such as Citi Sales Finance are becoming increasingly attractive because they can be well-suited for helping corporates to effectively de-risk balance sheets, improve free cash flows and enhance return on capital.

Such a holistic financing strategy can also help manage emerging market counterparty concentration risk. Citi helps clients monetize a portfolio of receivables and aims to work as a partner with large corporate suppliers to help meet the demand and drive growth for a diversified base of end customers.

Supply Chain Finance programs also combined with new Trade Finance strategies like Sales Finance can help companies extend their working capital while reducing risk. These strategies are growing to offer corporates an opportunity to help improve their balance sheet in these times of high interest rates and tightening liquidity.

Improving Efficiency through Innovation Can Offset Higher Costs

To help trim the fat, efficiency, transparency and increased adaptability are important treasury capabilities in times of change. Across the industry and especially in Citi's suite of global Trade solutions, there is a transformation taking place to help corporates stretch their bottom line as the liquidity belts tighten.

This is reflected in investments in technology and new ways of structuring financing strategies. On the technology front, Citi is one of the leading global banks invested in using OCR to help bridge the gap between manual paper documentation and digitizing trade processes. Citi's OCR Trade strategy has created a scalable operating model that helps to increase efficiencies, reduce costs and accelerate transaction turnaround times to improve the client experience. In the same vein, clients can opt to streamline onboarding processes by replacing traditional strategies such as trade loans and documentary letters of credit with digital strategies such as Citi's Electronic Trade Loans as well as the e-connect portal for Open Account.

Citi has launched new capabilities in digitizing trade to help benefit both the supplier and buyer. Online platforms can also help clients by increasing transparency to data insights while reducing costs, time and resources.

Finding the right banking partner can be crucial for optimizing working capital. Citi, as one of the industry-leading global working capital banks, can help provide the comprehensive capabilities and proven expertise to help corporates be prepared for today's environment and whatever lies on the road ahead.

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