Invesco Fixed Income Investment Insights

Implications of corporate repatriation on money markets

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Key takeaways

- Invesco Global Liquidity believes the repatriation of offshore corporate cash under US tax reform will not disrupt US or offshore money markets.
- Nor do we expect a repatriation-driven dislocation in money market interest rates.
- We believe the total dollar amount to be repatriated has been overestimated and the timing could stretch over several years.
- The relatively small amount of overseas cash held in money market balances further limits its potential impact on money markets. Most appears to be held in short- and medium-term US Treasuries and corporate bonds.

Repatriation tax overview

The 2017 US Tax Cut and Jobs Act applies a "deemed" repatriation tax to help pay for the cost of lowering the corporate tax rate to 21%. Unlike the previous voluntary repatriation holiday under the Homeland Investment Act of 2004, the current law imposes a mandatory one-time deemed repatriation tax on unremitted post-1986 foreign earnings of 15.5% on liquid assets and 8% on illiquid assets, regardless of whether the assets are transitioned to US parents. Companies can elect to pay the tax liability over a period of up to eight years in installments of 8% in each of the first five years, 15% in year six, 20% in year seven and 25% in year eight.

In this paper, we examine the possible implications for US and offshore money markets.

Size and allocation of unremitted foreign earnings

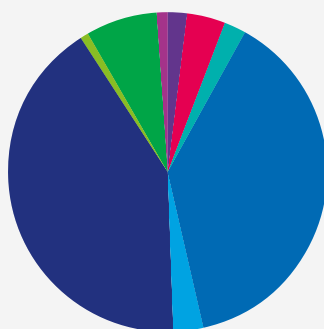
We estimate that US companies currently hold around USD3 trillion[1] in unremitted foreign earnings. Of the total balance, approximately half is held in cash and investments, with the remainder held in less liquid "operating assets" (plants, equipment, intellectual property, etc.).[2] An estimated 95% [3] of the cash and investments are held in US dollar denominated assets. These assets are highly concentrated, with the five largest cash holders, all technology firms, accounting for 38% of the total (Figure 1).

Using data for the five largest holders of cash as a proxy, we estimate that the majority of cash and investments are held in short and medium-term US government and corporate bonds (Figures 2-3). Non-government money market instruments account for around 8% of total cash balances - around USD120 billion (Figure 2).

Figure 1: Offshore cash balances
Top five cash holders (USD bn)

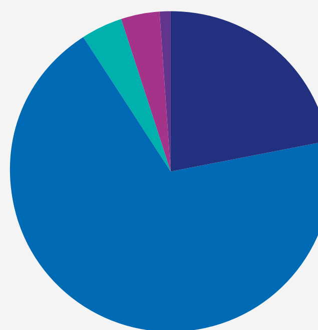
Apple	252
Microsoft	132
Alphabet	61
Cisco	69
Oracle	59
Total	**573**

Figure 2: Allocation of cash balances
Top five cash holders (%)



Corporate Bonds	41
US Govt and Agency	38
Non-US govt and agency bonds	3
Mortgage backed securities	7
Money market funds	4
Commercial paper and certificates of deposit	2
Cash	2
Municipals	1
Other	1

Figure 3: Maturity profile of cash balances
Top five cash holders (%)



1 yr	22
1-5 yrs	69
5-10 yrs	4
10 yrs	4
Other	1

Source Figures 1-3: 10Qs, data as of Sept. 30, 2017 (Apple, Microsoft, Alphabet), Oct. 28, 2017 (Cisco), and Nov. 30, 2017 (Oracle).

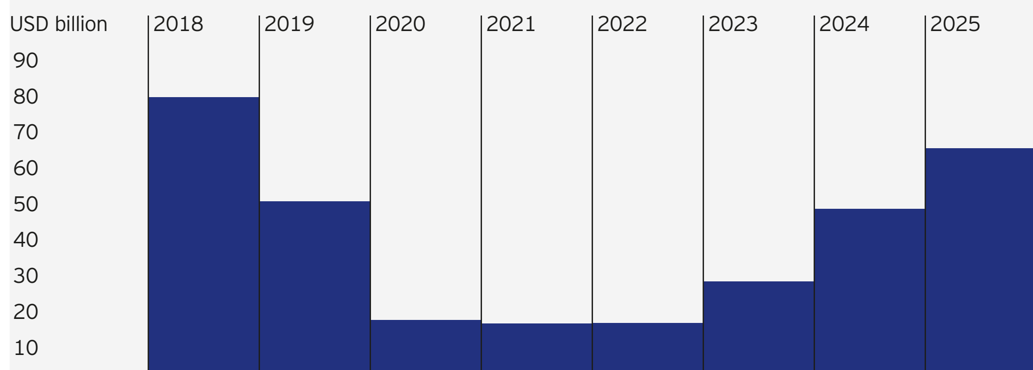
How much will be repatriated?

We believe the likely volume of repatriation has been overestimated. In our view, it is a misconception that USD3 trillion has been sitting idly in offshore bank accounts waiting to rush back in a wave. Rather, we believe the flow will be distributed over time, and will likely be lumpy. We believe the overall volume of repatriated assets will be closer to USD1.5 trillion, well below the widely anticipated USD3 trillion number for several reasons:

1. **As previously highlighted, around half of the USD3 trillion in unremitted funds is held in "illiquid" operating assets and not likely to be liquidated.** According to our estimates, this leaves around USD1.5 trillion in cash and investments that could potentially return onshore.

2. **A 2016 study[4] by Blouin, Krull and Robinson on the location and composition of unremitted foreign earnings found that only 14% of offshore balances was held in tax havens as cash and current assets, as of fiscal year-end 2009.** The study was based on the Bureau of Economic Analysis 2009 Annual Benchmark Survey of US Direct Investment Abroad. While somewhat dated, it suggests that a significant amount of cash was deployed for purposes other than pure tax optimization.
3. **Repatriation of cash to honor tax liabilities is likely to be spaced out over several years.** The US Joint Committee on Taxation (JCT) estimates the total tax liability on unremitted earnings to be USD339 billion,[5] but companies may stretch out payments over an eight-year period. The JCT expects tax payments to be front-loaded in the first and second years (USD79 billion in 2018 and USD50 billion in 2019) before tapering off (Figure 4). Tax payments are expected to pick up in years seven and eight, as installment percentages increase.

Figure 4: Estimated revenue from deemed repatriation tax



Source: JCT, Dec. 18, 2017.

4. **Because around 95% [3] of cash and investments is held in US dollar denominated securities, "repatriation" is likely to involve little more than changes in accounting entries, with no physical movement of cash, unless securities are sold.** In addition, given the deferral period on tax payments and because of the concentration of securities in the 1-5 year maturity range, we expect a portion to be held to maturity rather than sold.

How repatriated funds will be used

While many companies have highlighted their plans to increase employee compensation and capital expenditures in the US, we expect a significant portion of repatriated cash to be used for stock buybacks and mergers and acquisitions (M&A) transactions. We believe the repatriation tax will incentivize companies to use their own overseas cash to fund buybacks and M&A in place of debt issuance.

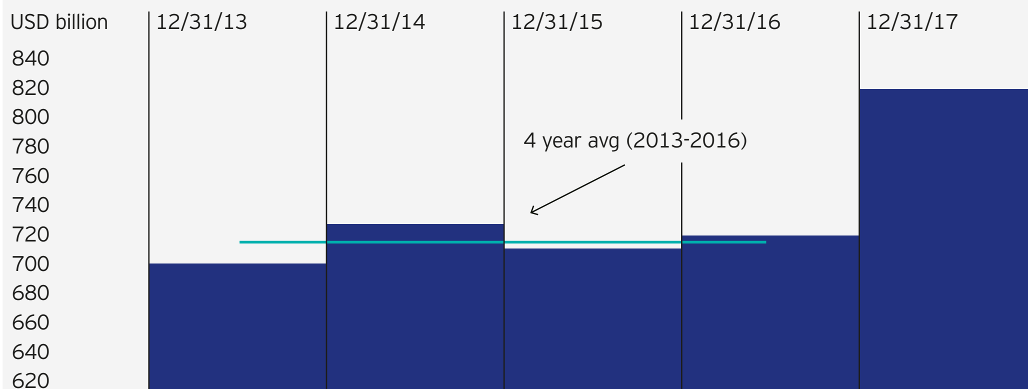
Implications for US money market funds

While the overall flow of assets back to US parents will likely be significant, we expect it to be less than anticipated and spread over an eight-year period for the reasons outlined above. Because the majority of companies' liquid assets are held in short and medium-term securities, we would expect many companies to allow their holdings of securities to mature. We expect this process to temporarily boost flows into US money market funds, as securities mature and before they are deployed for their ultimate use. Much uncertainty remains around the potential uses of repatriated cash and these uses could result in some lumpiness in flows. For example, since M&A activity is opportunistic and time-sensitive, cash returned for this purpose could produce large and short-term inflows into US government money market funds. Over the longer-term, we would expect the tax bill to result in additional flows into US government and prime funds, as the tax incentives are reduced for keeping future earnings abroad.

Implications for offshore money market funds

The overall allocation of offshore liquid assets to money market funds is modest, at around 4% of the USD1.5 trillion pool (Figure 2). Figure 5 shows that these balances were remarkably stable over the four-year period ending in 2016 and likely reflect companies' actual working capital needs. Balances have notably increased over the past year, suggesting that companies may be adding liquidity to help cover tax bills. We expect to see a drawdown in these offshore money market fund balances in the near term, as companies prepare for initial tax payments, but we would expect them to ultimately recover toward the average of the last few years to meet working capital needs. As previously discussed, there could be some large, time-sensitive transactions that cause companies to tap their cash balances, but we would expect these balances to be rebuilt as securities mature.

Figure 5: Offshore money market fund balances



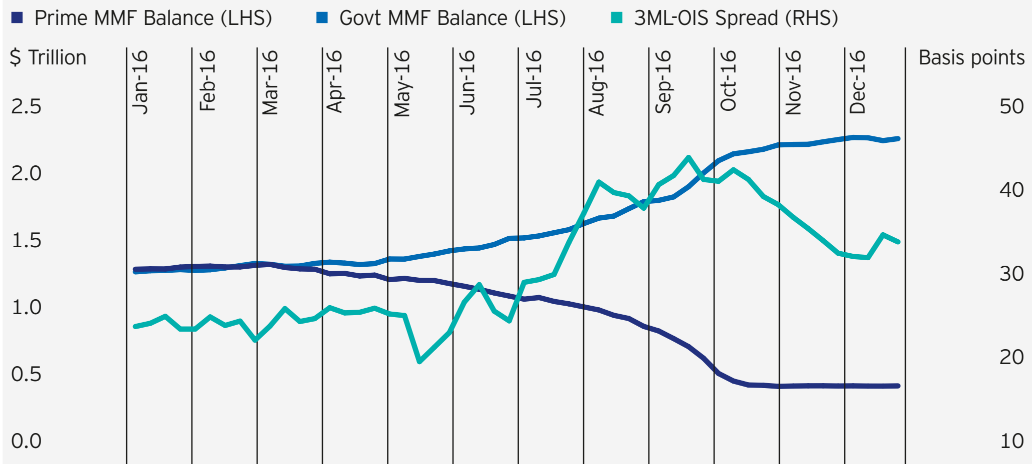
Source: iMoneyNet, data from Dec. 31, 2013 to Dec. 31, 2017.

Implications for money market interest rates

Given the small allocation to money market instruments relative to the total size of liquid offshore holdings, and based on our expectation that fund flows will likely be distributed over several years, we do not foresee a significant impact on money market interest rates due to repatriation. As a gauge for the potential impact, we look to recent US money market reform that took effect in 2016. In the year leading up to the Oct. 2016 compliance deadline, more than USD1 trillion[6] flowed out of prime money market funds, with the bulk switching into government funds. This flow out of prime funds into government funds represents more than eight times our estimate of the amount of offshore cash held in non-government money market instruments that could potentially be liquidated.[7] In terms of market impact, from the time prime fund outflows picked up in the second quarter of 2016 through the October compliance deadline, the 3-month Libor OIS spread increased by around 25 basis points, from a low of around 19 basis points to a peak of just over 43 basis points (Figure 6).

If we scale for the relative difference in the size of potential repatriation flows, this would imply a two-basis point widening in the 3-month Libor OIS spread over a similar time period. Considering this two-basis point move as a lower bound, we would anticipate an upper bound well below the 25-basis point move we witnessed in 2016. Given this potentially limited impact of repatriation, we would anticipate other factors, such as Fed interest rate hikes, to have a much greater influence on money market rates in the near-term.

Figure 6: Impact of US Money Market Fund Reform on Libor – OIS spread



Source: Bloomberg L.P., Investment Company Institute, data from Jan. 1, 2016 to Dec. 31, 2016. OIS is overnight indexed swap.

Please read the Investment risk section on the following page.

1 Source: The Joint Committee on Taxation, letter from Barthold to Brady/Neal, Aug. 31, 2016, Moody's "Corporate cash to rise 5% in 2017; top five cash holders remain tech companies", Richard J. Lane, Lenny J. Ajzenman, Invesco Ltd.

2 Source: CNBC.com, "Companies are holding a USD2.6 trillion pile of cash overseas that's still growing," Nick Wells, April 28, 2017.

3 Source: Brookings Institute, "Repatriated earnings won't help American workers–but taxing those earnings can", October 25, 2017.

4 Source, "The Location, Composition, and Investment Implications of Permanently Re-invested Earnings", J. Blouin, L. Krull, and L. Robinson, University of Oregon, December 2016.

5 Source: The Joint Committee on Taxation, Estimated Budget Effects of the Conference Agreement For H.R.1, The "Tax Cuts And Jobs Act", Dec. 18, 2017.

6 Source: FT.com, "US money market fund reform: an explainer," Joe Rennison, Oct. 14, 2016.

7 Source: Invesco estimates, 10Qs, data as of Sept. 30, 2017 (Apple, Microsoft, Alphabet), Oct. 28, 2017 (Cisco), and Nov. 30, 2017 (Oracle).

Investment risks

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