

Federal Reserve: Adding company debt to its portfolio

The Fed has taken another historic step; now adding corporate debt to its balance sheet. Not QE, but can feel like it if done in size. So far it is toe-dipping. And it should be no more than that, as the need for Fed help has been pulled back on many other fronts. The fall in Libor reflects this. That said, we are far from redemption. Just going through a positive patch



Fed Chair, Jerome Powell

The Fed dips into corporates through ETF buying; more to come

So, the Federal Reserve has finally made a start on its buying of corporate credit. They have bought their first USD 305m. We read this an average of USD 152.5m per day (spanning the 12th and 13th May). Difficult to say anything concrete about this from a statistical sense, or indeed to contextualise it. But we'll try.

"This is historic. It's not QE, as it is leverage purchases through a Fed sponsored special purpose vehicle. But still, it is symbolically important."

If we were to roughly annualise the daily volumes, it would sum to USD 36bn. That compares with a total firepower of up to USD 750bn for the corporate credit facility (although this includes use by the primary market facility). Contextualised against that, the opening buying spree has been moderate.

Another guidepost comes from the size of the ETF market. Focussing on the US, the total market capitalisation is in the area of USD 4.5trn. But most of this is in equities. The bond component sums to USD 900bn. The annualised purchases so far point to 4% of this. That said, these are early days, and a simple annualisation is far from a perfect guide.

"Corporate debt will show up on the Fed's balance sheet, a direct stake. These are not equity stakes though. Default/credit risk is one thing, but the potential for wipe-out is a whole another dimension."

We don't know exactly what the Fed has bought. We assume it is ETFs. We don't know to what extent it might have included high yield, but we'd suspect they did dip into that space. The Fed will report monthly on what exactly they have been buying.

This is historic though. It's not QE of course, as it is leverage purchases through a Fed sponsored special purpose vehicle. But still, it is symbolically important. Corporate debt will show up on the Fed's balance sheet, a direct stake. These are not equity stakes though. Default/credit risk is one thing, but the potential for wipe-out is a whole another dimension.

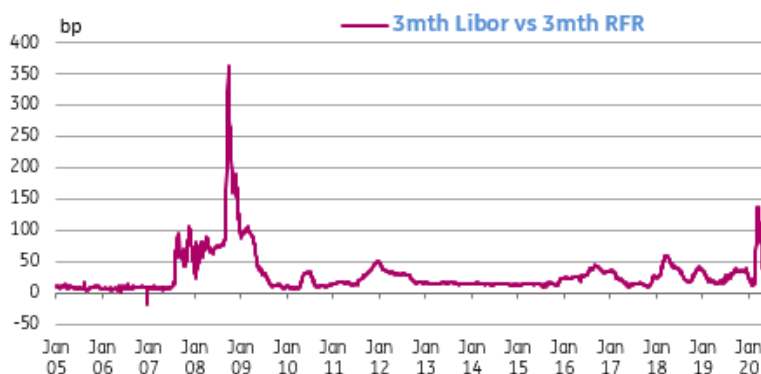
Fed support provided for other parts of the system are lower again

In terms of the other facilities, we see further evidence of the Fed easing back on the need to provide support. Support for money market funds fell again. This peaked in the area of USD 55bn in mid-April and has since fallen back to USD 40bn. And support to the commercial paper market is running at just USD 4bn. It has never really had to be deployed in size (although it did take some time to set up).

Support through securities buying has slowed to USD 41bn for the latest week. This compares with weekly purchases of USD 250bn to USD 350bn per week about a month ago. So the Fed is still there, but the buying is well down from where it was. Also, Buying of mortgage-backed securities has halved to USD 25bn for the latest week.

There have been some increases though, more in the area of supporting smaller businesses. The paycheck protection programme has seen a further USD 11bn of Fed support and is now running at USD 41bn. Main Street lending facilities are coming too, which will help most smaller operations. These will be put to work, as angst here remains elevated.

Impressive recent fall in 3mth Libor back towards the risk free rate



"The positive effect of all of these facilities is to be seen on the ability for 3mth Libor to show a material fall. From a very elevated 1.45% in mid-April, it fell below 40bp yesterday."

USD Libor has managed an impressive fall in consequence

The positive effect of all of these facilities is to be seen on the ability for 3mth Libor to show a material fall. From a very elevated 1.45% in mid-April, it fell below 40bp yesterday. We suspect this has the feel of an overshoot to the downside as it is happening so quickly, and in the end, Libor should reflect an elevated bank credit risk. But either way, our target is for Libor to get to the 30bp area in the end, maybe the high 20's bp.

And the Fed still has other facilities coming; they may be needed

Another positive element for the latest week has been a small reduction in take-up of central bank liquidity swaps. They are down USD 2bn on the week. That is small compared with an outstanding of USD 440bn. But it is the first fall in quite some time. It shows some easing off on desperate quests for off-shore dollars. We are not convinced this is sustainable though, given the ongoing pressure on some high-beta emerging market currencies.

More facilities are in the works too. Many of these are aimed at supporting credit markets further. Help for municipalities needing to raise cash is one. Another is the primary market corporate credit facility, although more for stressed corporates that can't fund (and at a 100bp fee). Support for

asset-backed-securities is also in the works.

While the current environment is better than it was a few weeks back, it would be a mistake to extrapolate the last few weeks into the future. There is still a mountain of uncertainty in the months ahead, one that will likely uncover numerous corporate defaults and too many main street ones to be in any way comfortable with.

These will pressure the system, likely putting most of these facilities to work. We watch here the muni facility in particular, as the build of debt is symptomatic, to finance shutdowns and their repercussions.

Bottom line, the fall in 3mth Libor tells the story. When it hit 1.45% some weeks back we were in the midst of a significant elevation in systemic pressure. Corporates were desperately liquidating money market funds' assets to raise cash against a backdrop where the primary market had closed. They were drawing on bank revolvers too. The pressure was intense.

The Fed came in with one facility after another. Many are still not fully utilised, but the market healed. Some self-corrected. For example, the commercial paper market got back on its feet well before the Fed had its tailor-made program up and running; hence it's minimal take-up (which is at a penal rate in any case).

A wider scan also points to less pressure generally. This week the Fed ended also its 3mth repo facility, as the secured financing market too is in better shape, partly as the Fed's balance sheet has mushroomed again, with reserve bank credit now at an historic high of USD 6.7trn (massive for an economy of USD 21trn).

The Fed is in here for the long game. Many of these facilities have September as an end date. We are good till then at the very least. Ideally, the Fed will not have to employ e.g. its corporate credit facility to its full extent, as that would indicate a welcome healing process underlying the bandages that the Fed is applying. To be seen.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s).

as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.