

Dollar hoarding: It's hard to let go

As the dollar bear trend starts to gain momentum, questions will be asked about all those dollars hoarded in March - an exercise associated with an 8% dollar rally that month. Delving into some new data on the amounts and the participants involved, we look for clues as to when these dollar hoarders might be prepared to let go



Source: Shutterstock

Dollar hoarding: What is it?

When I think of dollar hoarding, one episode really stands out for me. It was during the Russian crisis in late 2014 when Russian corporates were reluctant to sell their USD export earnings back into the local FX market. This USD hoarding was sending USD/RUB through the roof until some local moral suasion was used to encourage Russian exporters to offload their dollars for roubles.

But a quick Google search for 'dollar hoarding' now typically delivers references to events in March this year when a funding squeeze drove the dollar higher. At the time corporates were being blamed for the move as they sought access to precautionary stockpiles of dollars ahead of expected supply chain disruptions. The Financial Times lent some support to the story with reports that corporates had drawn down US\$124bn from their bank credit facilities in the last three weeks of March - a time when a traditional supply of USD funding - the Commercial Paper market - had seized up.

Trying to pin down this hoarding activity in terms of data is a challenging task

ING's [Markets team wrote a lot](#) on this subject at the time and in addition, [this BIS paper](#) delivers some useful analysis of this issue – especially on some of the key protagonists on both the supply and demand side of the dollar funding story. On the demand side of the dollar funding equation, there is a myriad of dollar users as a result of the currency's dominance in trade and financial flows. In addition to corporates, there is large buy-side demand for dollar funding to hedge USD-exposed diversified portfolios. And, of course, banks play a major role here – European banks' dependence on the wholesale markets to fund USD loan books had been a major source of distress in 2008.

Trying to pin down this hoarding activity in terms of data – and what it means for the dollar in general – remains a challenging task. But we think we've found a few clues.

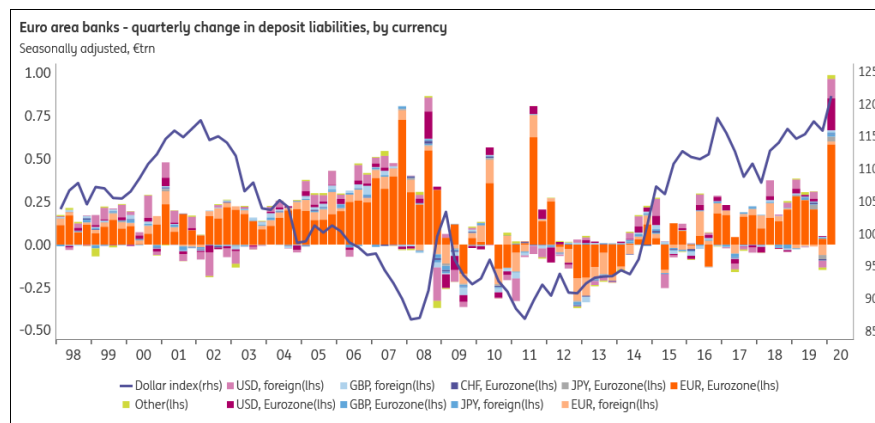
Insights from Europe

If the narrative of dollar hoarding plays out, USD deposits should show up somewhere. Where better to look for those USD deposits than from the banks, which report changes in deposit liabilities to their local supervisors. For the eurozone banking sector, ING's Teunis Brosens routinely analyses the monthly 'Monetary Developments in the Euro Area' release from the ECB. Here it seems that some of this dollar hoarding activity may have emerged in the March publication.

Teunis's chart below shows how euro area banks have seen their deposit liabilities surge by close to EUR1trn in 1Q20. This is the largest quarterly increase on record. Well over half of that is in euros and reflects local liquidity hoarding by banks, corporates, and financials. The stand out for us in this chart is the increase in USD deposit liabilities reported by Euro area banks – at almost EUR300bn. This well exceeds the prior record increase of EUR240bn also seen at the time of a major dollar funding squeeze in 2008.

Looking at where those USD deposits derived from, the ECB data shows a roughly 60:40 split in favour of eurozone over non-eurozone residents. Also, look at the dollar performance during this period – stress and the large build-up of deposits have typically been associated with a stronger dollar. This supports claims for the dollar to be the world's only true funding currency.

Euro area banks - quarterly change in deposit liabilities by currency



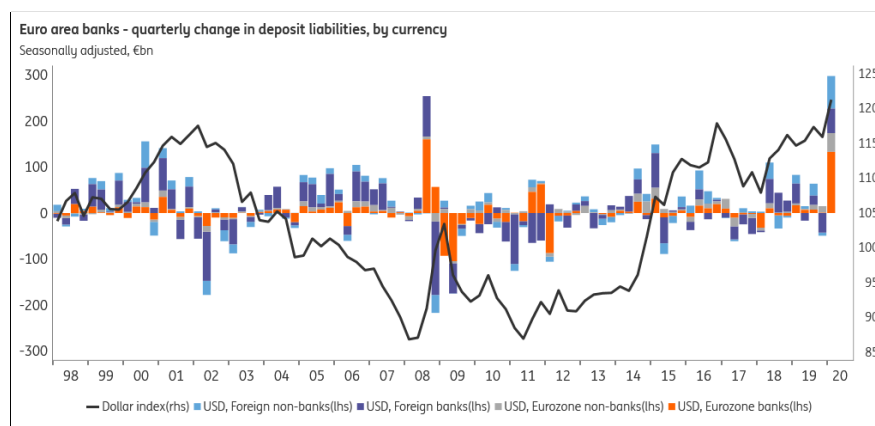
Source: ING, ECB

Hoarding: A banking or corporate phenomenon?

In addition, the ECB data disaggregates these USD deposits into bank versus non-bank lenders. Was it all corporates preparing for supply chain challenges or more the banking community driving the rise in USD deposits? The data suggest that banks accounted for two-thirds of the rise in USD deposits (about EUR185bn). That still means that non-banks, including corporates, grew their USD deposits at Euro area banks by over EUR100bn in 1Q20. But we suspect that the narrative of corporates drawing USD via bank credit lines – and paying anywhere up to 1.00% p.a. for the privilege – may not be the key driver here.

Instead, we suspect that the euro area banks' use of the Fed's USD swap lines is driving the show. Eligible counter-parties can secure USD funding via seven and 84-day swap facilities, auctioned by the ECB. By the end of March, the ECB had lent out around US\$100bn to euro area banks through these Fed swap lines. And it may be the use of these Fed USD swap lines that provides the most timely signals for the precautionary dollar funding story.

Euro area banks - quarterly change in USD deposit liabilities, (by region and by participant)



Source: ING, ECB

Reading the tea leaves and dollar implications

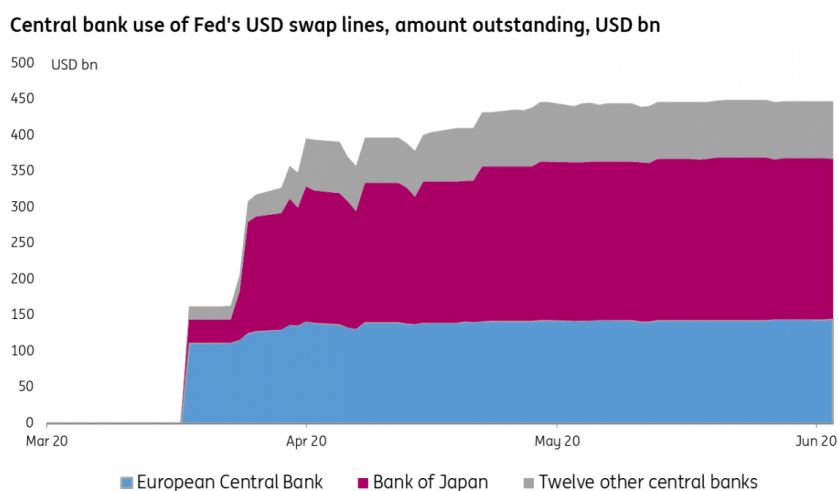
If the use of the Fed USD swap facilities could be the key driver of the USD deposit swing, then the good news is that data on its use is made available [in a timely manner by the Fed](#). Currently, 14 central banks have access to the Fed's USD swap facility, borrowing a current total of US\$447bn.

There is a view that these precautionary dollars stay held into 2021 as banks wait to see the level of bankruptcies (our credit team sees 10-12% default rates in the European High Yield arena versus 6% priced by spread indices) or wait for a second wave of Covid-19. That caution makes sense and certainly, there are no signs as yet from the Fed data that banks are prepared to let their USD borrowing roll-off.

However, the total amount now borrowed from the Fed is not far off the peak use of Fed dollar swap lines in December 2008 – then at US\$580bn. Somewhat surprisingly those dollar swap lines were wound down to zero by the end of 2009 – by which time the Broad Dollar Index had fallen 15% from its highs. Currently, the Broad Dollar Index has only fallen about 5% from its March 2020 peak.

We will now certainly be adding the use of the Fed's USD swap lines to our toolkit. Any signs that banks are prepared to let their precautionary USD borrowing roll-off would add weight to our preferred view of more normalised conditions, [a return of portfolio flows to emerging markets](#), and a benign dollar decline leading EUR/USD to 1.20 by year-end.

Central banks use of Fed's USD swap lines, amounts outstanding (USD bn)



Author

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@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 www.ing.com.