

Covid-19: The global battle continues

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Watch: Why the Covid-19 stimulus measures aren't always what they seem

Governments around the world have pledged billions to help their struggling economies during the coronavirus crisis. But ING's Rob Carnell in Singapore says the quoted figures aren't the full story. In Asia, some of the fiscal measures announced also include things like 'soft loans' and deferred payments which will do little to boost GDP growth



Source: Shutterstock



Why the Covid-19 stimulus measures may not be all that they seem

Rob Carnell, ING's Head of Asia-Pacific Research, on the stimulus measures announced by countries across the continent

[Watch video](#)

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Pandemonics: How Covid-19 could change the world

We are nowhere near knowing when the Covid-19 pandemic will end or how bad things will really get. But the world may never be the same again. The pandemic will shake up not only healthcare, but politics and business, culture, society and our well-being. Combining several disciplines, we identify 15 shifts that may confront us over the coming years



Source: Shutterstock

- 1. Big government is back** - Covid-19 has forced governments to intervene in the economy and daily life in a way unprecedented in peacetime. More changes will come after emergency lockdowns and support has ended.
- 2. Peak populism** – populist politicians will push their nationalist agendas, pointing to the dangers of unbridled openness, but some countries may embrace a more focused internationalism to tackle global problems.
- 3. Competence matters** - governments and companies that fail to show competence and compassion amid lost lives and livelihoods will rapidly lose trust and support. Their retributions may fuel ongoing conflict.

- 4. From monetary to fiscal** - a further radical transformation of macro policy will cast a long shadow. With fiscal rules cast aside, dealing with a massive build-up of debt will be an enormous challenge.
- 5. Inequality matters** – it's not just a matter of fairness, it's a matter of social stability and public health security. Society's dependence on often low-paid and vulnerable people providing vital services is now in the spotlight.
- 6. 'Too many to fail'** – pandemic lockdowns will lead to a shake-up in the service sector, especially in high social contact areas such as leisure, which are dominated by small businesses, the low-paid and self-employed.
- 7. Collateral damage** – government intervention in the financial system will continue. Beyond a rethink of how to keep financial markets functioning in future crises, a surge in insolvencies will leave a painful legacy.
- 8. Rethinking efficiency** – the pandemic exposed the dangers of over-optimising processes, which leave little slack to deal with sudden setbacks. Instead of 'just in time', the ethos will shift to bigger 'just in case' inventories.
- 9. Rethink risk management** – businesses will shift from linear thinking based on quantifiable risks based on past precedent to a new focus on mastering uncertainty with resilience and agility.
- 10. Rethinking supply chains** – the fact that the pandemic emanated from China, the modern-day 'workshop of the world', exposed the vulnerability of global supply chains.
- 11. Expertise matters, and it needs to be diverse** – on top of epidemiology, investments in science, both physical and social, will be needed to help inform difficult political, ethical and economic choices on future challenges.
- 12. War on disease** – the huge human and economic toll of pandemics will push investments in health research and systems to the top of the agenda and add to the urgency of addressing other global threats to sustainability.
- 13. From physical to digital** – sustained curbs on travel and enforced working from home during the pandemic will lead to a steep increase in people interacting digitally, radically shaking up the structure of the economy.
- 14. Lasting shifts in consumer behaviour and social norms** – the mortal threat posed by social interactions has shifted our thinking about how we relate to our households, families, neighbours and communities.
- 15. More benign surveillance of individual health and social interactions** – the benefits of tracking of personal health and our interaction with others may be reconciled with privacy and security by decentralised technology.

[Read about our four scenarios for the global economy after Covid-19](#)

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Carsten on the crisis: What the eurozone needs to do next

2020 will probably be the worst year for the eurozone since the financial crisis of 2008 or maybe even worse. That's according to ING's Head of Macro Research, Carsten Brzeski. While governments and central banks have already done a lot to tackle the economic fallout of Covid-19, what's still missing, he says, is a pan-European fiscal reaction



Eurozone 2020: Things could be even worse than after the financial crisis

Carsten Brzeski on the fate of the eurozone amid the coronavirus crisis

[Watch video](#)

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Snap | 9 April 2020

ECB: The seven days to Lagarde's 'whatever it takes'

The just-released minutes of the 12 and 18 March European Central Bank meetings illustrate the ECB's road to another 'whatever it takes' moment and suggest that both a rate cut and more quantitative easing should not be ruled out



Source: Shutterstock

What a difference a month makes. At its 12 March meeting, the ECB had already started to analyse the potential impact from Covid-19 on the eurozone economy but the full impact was still more a possibility than reality. A couple of – to say the least – sub-optimal comments by ECB President Christine Lagarde at the last press conference, added more nervousness in financial markets. What followed was a series of events that will not win any awards but at least ended with an important U-turn. While at the 12 March meeting, Lagarde said she didn't "have a claim to history for being 'whatever it takes' number two", the announcement of a Pandemic Emergency Purchase Programme on 18 March had, in fact, become Lagarde's 'whatever it takes' moment.

The just-released minutes of the two meetings from 12 March and 18 March illustrate the changing views of the ECB within one week. From first hoping that it would be enough to an all-in response. It's a long read to go through both minutes. To save you some time, here are our highlights.

12 March meeting

- Back then, the ECB was already thinking in terms of scenarios, taking into account that additional lockdowns would follow the Italian example.
- The fear was that the government measures would not only reduce economic activity sharply in the short run but could also spread to the rest of the economy over time.
- The ECB flagged the risk that the temporary demand and supply shock could eventually lead to a fully-fledged macro and financial crisis, ending with long-run damage to the supply side of the economy.
- QE was the preferred option over another cut of the deposit rate.

18 March meeting

- The sense of urgency had increased significantly, reflected in statements like “there was an urgent need for the Governing Council to reassess its policy stance and instruments to address the economic consequences of the evolving coronavirus pandemic.”
- Not all members supported the decision to launch a new, dedicated asset purchase programme but seemed to prefer the option of increasing the ongoing QE programme or considering Outright Monetary Transactions.
- At the 18 March meeting, the option of a rate cut was brought back into the discussion, in order to lower the risk-free curve.
- Some members suggested that the ECB could already flag that “additional asset classes could in the future be accommodated within the scope of the proposed purchase programme, beyond the inclusion of commercial paper”.
- Not all members agreed with the decision to drop the issuer limit.

Normally, ECB minutes are closely analysed to find any hints at future policy moves. The minutes of the 12 and 18 March meetings, however, are more an illustration of evolving assessments within the ECB. If anything, additional rate cuts should not be ruled out entirely, as some ECB members still seem to support them. More generally, the U-turn by Christine Lagarde to do whatever it takes clearly suggests that the ECB stands ready to do more, if need be.

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Austria's Covid-19 exit strategy

Austria was one of the first countries to go into a complete lockdown and is now at the forefront of exiting the Covid-19 measures. Will this strategy be successful and could it serve as a blueprint for the rest of the eurozone?



Source: istock

Covid-19 measures will be eased

The Austrian government announced a relaxation of the Covid-19 measures at a press conference today. Namely:

- From 14 April, small shops, do-it-yourself stores and garden centres will be allowed to reopen
- From 1 May, all shops, shopping centres and hairdressers will be allowed to reopen
- Restaurants, hotels and other service providers will probably be able to open gradually from mid-May.

Yet, the curfew will be extended until the end of April, allowing people to leave the house for just four reasons; to go to work, to make urgent errands such as to buy groceries, to help other people in need and to go for a walk or exercise. Also, bigger events may not take place until the end of June. The measures will be reviewed every two to three weeks and will be adjusted on the basis of the data available.

Still, the economic impact will be huge

Despite the early lockdown measures and the impending relaxation, the economic hit to the Austrian economy will be large. [In our base case scenario in our monthly economic update](#), we assumed the lockdown measures would be relaxed at the end of April, with only a gradual return to normality. Given the importance of the tourism sector, the already large hit to recreation, hotels and restaurants, as well as to the manufacturing and trade sectors, we expect the Austrian economy to contract by 5.3% year-on-year in 2020, which would be the strongest contraction since 2009.

The government's aid package will help to smooth the impact on businesses and livelihoods, but cannot prevent the economy from falling into a deep recession this year. Still, the package will help to safeguard jobs and the liquidity of companies. Just this weekend, the crisis management fund was increased from €4 billion to €28 billion with the hardship fund for SMEs raised from €1 billion to €2 billion while funds for short-time work are to be increased from €1 billion to €3 billion. Nevertheless, the Austrian unemployment rate rose to 12.2% in March (national definition), an increase of 4.7 percentage points compared to the previous year. Compared to the previous month, the number of unemployed rose by 51%.

"Despite the early lockdown measures and impending relaxation, we expect the Austrian economy to contract by 5.3% YoY in 2020."

A blueprint for the rest of Europe?

Austria has been (one of) the epicentres of the Covid-19 outbreak in Europe. The Austrian government took strong and prompt action to limit the spread of the virus. Now, Austria is the first eurozone country to announce a loosening of the lockdown measures. If Austria's exit strategy turns out to be successful, other countries will follow.

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CEE Sovereigns: Fiscal and rating impact from Covid-19 crisis

Growth contraction and fiscal support packages will see fiscal deficits and debt ratios spike in 2020. This shouldn't be a problem for Bulgaria, Czech Republic and Poland thanks to moderate debt ratios, but could wipe out gains for Croatia, Hungary and Serbia. In this note, we look at fiscal balance sheets in the CEE region & the impact on sovereign ratings



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Bank of England and Treasury announce temporary monetary financing

The agreement between the Bank of England and UK Treasury to give the latter access to a larger overdraft will rekindle the debate over direct monetary financing. But assuming the overdraft proves to be a temporary stop-gap, as it was in 2008/9, then it should help money market functioning. We don't expect it to be particularly negative for sterling



The 'Ways and Means' account

[The Bank of England and the Treasury agreed on Thursday](#) to expand the government's overdraft facility – officially known as the 'Ways and Means' facility – with a stated goal of allowing the government to smooth its cash flow.

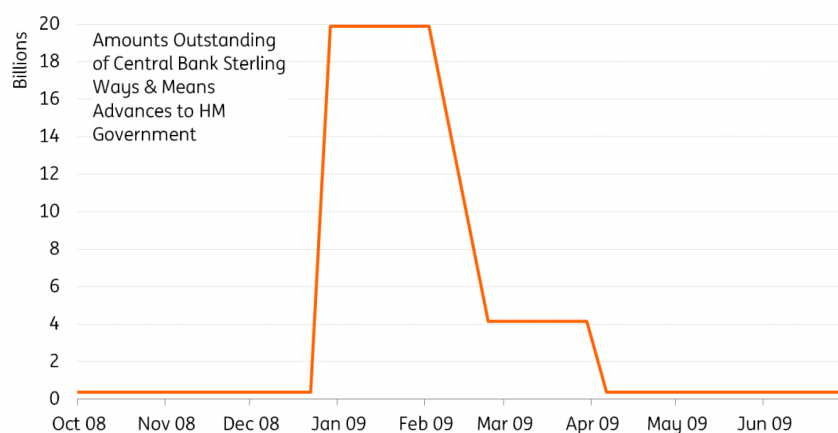
Against the backdrop of rising national deficits globally, this story will undoubtedly help rekindle the discussion over direct monetary financing as a tool to deal with all the extra government spending related to Covid-19. And it follows a string of proposals, not least from former [Deputy Governor Charlie Bean](#), to move towards funding the government more directly, for example by buying bonds in the primary market.

Before getting ahead of ourselves though, it is important to remember this overdraft facility isn't new – and has been used before. Back in 2008, there was a similar agreement and the Treasury drew £20 billion from the Bank of England facility, for a period of around six weeks, according to official data. In normal times, this facility usually totals around £400 million.

In the end, everything depends on whether the usage of this facility is temporary. And assuming it is, we think it should help money market functioning, in so much as it should prevent the market from choking on Gilts (more on that below). Investors will assume that whatever is borrowed from the BoE will be refinanced on capital markets.

The bigger question for the 'is it/isn't it' direct monetary financing debate, will be how the Bank of England gets involved when the Treasury does refinance any overdraft position. Further QE is likely if needed to contain rises in market rates, but will policymakers resort to more direct forms of financing as some have proposed? For the moment, the Bank is keen to make clear it's independence means [such policies are not on the cards](#).

How the 'Ways and Means' account was used in 2008/9



Source: Macrobond

Will the temporary become permanent? Unlikely...

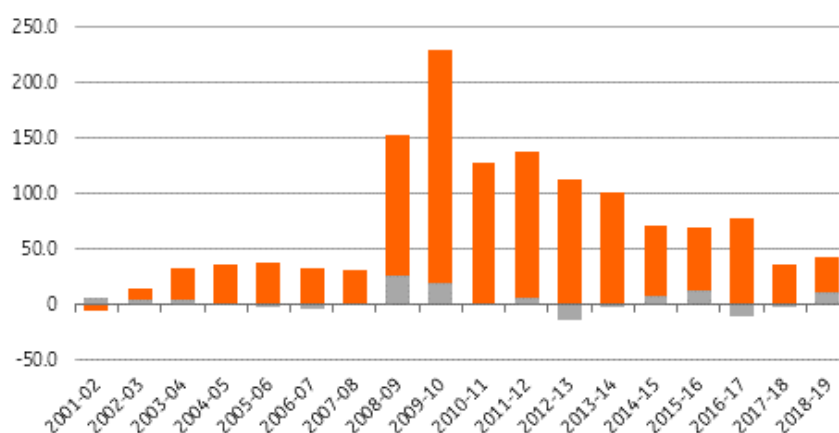
From the point of view of sterling rates, the reinstatement of the facility raises two questions: is it credible that it will indeed be a temporary cash management tool, and how this will later impact money markets and long-dated interest rates?

On the first question, it seems sensible to compare deficit forecasts to the Debt Management Office's (DMO) borrowing capacity. We appreciate this is very early in the crisis and any estimate is liable to be revised higher if the economic disruption lingers but we use the Institute of Fiscal Studies' £175bn forecast as a starting point. Whilst that figure seems impressive at first, the DMO managed to raise £150bn in fiscal 2008-09, followed by an additional £230bn the following year. This was at a time nominal GDP was lower than currently, and the BoE has already announced a £200bn boost to QE.

If HM Treasury's drawdown of the facility remains in the same ballpark as historical usage, around £20bn, we can safely say that it has the capacity to refinance it with regular bills and Gilts issuance in subsequent weeks and months. Even larger amounts would make sense as long as it is clear they are temporary. Given the speed at which economic hardship is hitting the private sector,

it is conceivable that even the DMO does not have the ability to raise these sums on time however. For instance, since 2001, the greatest one month Gilt net issuance it achieved was £28bn.

Total bill and Gilt net issuance per fiscal year



Source: Debt Management Office, ING

A relief to money markets and Gilts

This brings us to the second question about the impact on the functioning of GBP money markets (MM) and long-dated rates. At a time central banks are scrambling to restore the functioning of MM, [for instance with the commercial paper facility](#), a sudden increase in the amount of debt instruments would be counterproductive: think of additional bill issuance as mopping up the liquidity the BoE is trying to add to the system, and crowding out corporates funding. In that sense, the introduction of the facility is a positive development and we would even recommend that it is used aggressively at first to prevent a disruption to money markets.

Where longer-dated rates are concerned, aggressive use of the facility would also prevent the market from choking on Gilts. Clearly investors are going to assume that whatever is borrowed from the BoE will be refinanced on capital markets but it will be reassuring to them that not all of it is issued at once. What's more, it is hard to imagine the central bank will let a sharp rise in interest rates occur at a time when both private and public debt are on an explosive trajectory. Gilts trade with a strong BoE put embedded in them implying further purchases would materialise if necessary.

GBP impact unlikely to be overly negative, given BoE may be an outlier in form, but not in essence

We don't see today's announcements as overly negative for GBP. This is because:

1. In these uncertain times, what would normally be deemed as aggressive measures are being forgiven by markets and given the benefit of the doubt. Recall the limited GBP reaction to the large UK fiscal stimulus announced in March, as well as the subsequent rating outlook downgrade. What matters at this point is the impact on the economy and stability of financial markets. We view Thursday's announcement through the lens of the financial stability prism, which should be positive for Gilts (see above) and not negative for FX.

2. The BoE enjoys a high degree of credibility. This is important as it is necessary for the markets to believe that today's announcement is a short-term, time-limited, extraordinary measure which won't last beyond 2020. This, in turn, should keep any negative effect on GBP fairly limited.
3. While the BoE is the first major central bank to talk about/allow for what may be described by some as direct monetary financing, one can argue similar things are happening elsewhere, albeit indirectly. The increase in size/roll out of QE among central banks globally (be it in developed or emerging markets) with a partial aim to alleviate pressure on the domestic bond markets (due to the increase in bond issuance) provides a case in point. Here, the BoE may be an outlier in form (financing the government directly), but not necessary an outlier in essence (containing government borrowing costs).

We therefore don't look for a material negative effect on GBP and don't see the need to change our forecasts on the currency with a more negative outlook. We continue to target the EUR/GBP 0.85 level by the year-end.

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Poland's central bank cuts rates and raises implicit QE

After the extraordinary rate cut in March, Poland's central bank did their own version of 'whatever it takes' by cutting rates further by 50bp. They are also using unconventional measures via higher implicit QE, up to 8.4% of GDP. This is slightly negative for the currency



Source: Shutterstock

Another rate cut and more QE

Poland's central bank decided to cut rates by 50 basis points with the main rate at 0.5%, depo at 0% and lombard at 1%.

We are forecasting a 4.5% year on year contraction in Polish growth, so expected only a 25bp rate cut in May or June, but the Council decided to frontload easing and pre-emptively deliver stimulus.

In March, the central bank delivered conventional easing with the 50bp base rate cut, slashing of the mandatory reserve which released PLN40bn of liquidity and unconventional measures including launching de facto quantitative easing and TLTROs.

There is no explicit limit to Polish QE, as the central bank calls this

an open market operation stabilising the yield curve and monetary transition. But in reality, this is quantitative easing

Today, the central bank not only cut rates by another 50bp but also implied that Polish QE will be ramped up. Previously, the central bank was only purchasing Polish government bonds, but today the list of eligible instruments was extended to other bonds with state guarantees. That should support the new anti-crisis program call financial shield.

The Polish Development Fund should issue bonds funding the new program and those bonds should be bought by NBP.

There is no explicit limit to Polish QE, as the central bank calls this an open market operation stabilising the yield curve and monetary transition. But in reality, this is quantitative easing.

We estimate that NBP should buy up to PLN185bn bonds, including PLN 85bn of POLGBs (3.9%GDP) and new bonds with state guarantees (up to PLN100bn, ie 4.6% of GDP). The purchases of bonds with state guarantees depends on the new financial shield taken by companies, which is highly uncertain. In the extreme case, Polish implicit QE should reach 8.4% of GDP. This is quite high, as the Federal Reserve's first QE measures reached around 9% of GDP.

PLN should no longer outperform CEE FX as Polish monetary easing is more aggressive than elsewhere, this is also mildly negative for the currency.

The new anti-crisis program - loans convertible to subsidies worth of PLN100bn

Apart from the easing by the central bank today, the government has announced a financial shield - a large programme of preferential loans to enterprises for a maximum of a three-year period. The program is worth PLN100bn, of which PLN25bn will be dedicated to microenterprises (zero-nine employees), PLN50bn to small and medium-sized companies (10-250 employees) and another PLN25bn to large enterprises. In the case of big companies, the state will be able to buy shares of the companies in trouble on market terms.

The loans will be disbursed via commercial banks with a simplified application path. However, only companies with decreasing turnover by more than 25% during Covid-19 period will be eligible. The loans will be subject to large forgiveness (up to 75%) provided that its beneficent companies maintain employment and operation for at least a year.

The funding for this loan program will be provided mainly by debt issued by PFR Group (Polish Development Fund) and purchased by NBP. In such a way it is possible to circumvent the constitutional limit for public debt (60% of GDP). However, the additional debt will be included in the EU definition of public debt. It will also raise the general government deficit for 2020 above 10% of GDP (how much exactly depends on Eurostat interpretation).

The popularity of the new program should determine the size of borrowing needs and central bank purchases of assets. The government assumes it should reach up to PLN100bn, but the conditions attached will determine the uptake. A quarter of the program applies to

big companies, where the Polish development fund exit from companies should be clearly stated, otherwise the popularity of the programme might be a bit low in this group.

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US: The Forceful Fed

The minutes to the emergency 15 March FOMC meeting show the Fed quickly grasped the economic and financial market threat posed by Covid-19 and the importance of an aggressive response to mitigate the dangers. Policy will not be reversed until it is clear that the Covid-19 threat has passed and the economic hangover has gone



Source: Shutterstock

Forceful Fed to stay the course

The minutes to the Federal Reserve's emergency FOMC meeting on Sunday, 15 March, at which policymakers cut rates 100bp and re-instigated quantitative easing, emphasised the desire to show a "forceful" reaction to the economic threat from the Covid-19 crisis.

Rates to stay at zero

Officials highlighted the "extremely large degree" of uncertainty, but stated explicitly that rates would stay at zero "until policymakers were confident that the economy had weathered recent events and was on track to achieve the Committee's maximum employment and price stability goals".

We already knew that Loretta Mester formally opposed the full 100bp reduction in favour of a more cautious 50bp reduction, but the minutes also show that she was not alone in having reservations. Initially, “a few participants” preferred 50bp and to “wait until there was greater assurance that the transmission mechanism of monetary policy via financial markets and the supply of credit to households and business was working effectively”. However, in the end they were convinced to go with the majority in favour of 100bp.

With regard to the quantitative easing, FOMC members wanted to stress the primary purpose was to “support the smooth functioning of Treasury and agency MBS markets rather than to provide further monetary policy accommodation by pushing down longer-term yields”. Nonetheless, a “couple of participants noted that because some of the purchases would be at longer maturities, the purchases could provide some accommodation by lowering longer-term yields”. It seems likely that these voices grew louder given the Fed subsequently expanded its QE to become “unlimited”.

Low for longer...

It is important to emphasise that the Federal Reserve’s response was largely to mitigate the threat of dislocations in credit markets compounding the direct economic threat from Covid-19. Financial market strains have largely eased, but some tensions do remain and the Fed continues to show clear intent to deal with those rapidly and forcefully. We are now more focused on the fiscal support, which is clearly also sizeable and may well be stepped up further in the coming months.

Nonetheless, this is all about tiding households and businesses over until the economy re-opens. This will take time though with US restriction continuing through to the end of the month. We also have to recognise that there could be setbacks along the way that could reignite financial market tensions – we will be closely following how the re-opening process develops in Austria that starts next week.

Even if we do start to see the US begin the process in May, it will take time to return to business as usual. Moreover, we continue to expect the economy to contract more than 12% peak to trough with the lost output not recouped until the summer of 2022.

We expect the economy to contract more than 12% peak to trough

Importantly, Fed officials also believe that inflation will weaken and stay low – “reflecting both the deterioration in resource utilisation and sizeable expected declines in consumer energy prices”. As such we see little prospect of the Fed reversing course and taking back any of their stimulus and support measures for at least the next twelve months.

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The biggest plumbing bill, ever

The Fed has piped the financial system with a myriad of mechanisms in recent weeks. We break these down and make sense of what is on the mend, and what could lie ahead. The clearest barometer of success would come from a fall in Libor, which remains elevated. April is an important month as the Fed's various SPVs kick into gear. Libor should fall. But then again ...



Why Libor is an important barometer of stress

The risk-free rate in the US is zero, in fact, it now peppers frequently into negative territory. In contrast, Libor is at 1.4%, which is a problem, as it flags an elevated implied bank risk. Its elevation is in part a reflection of default risks that lie ahead, and especially as the veneer of exceptional government and central bank supported is eventually lifted. Many of the Fed measures have September as a preliminary end date. When those get lifted, many businesses will find that the world has changed for them.

But the elevation in Libor is not all about default risk. It also reflects implied pressures coming from other aspects of plumbing in the financial system.

How the stress built despite the Fed's massive QE program

The Fed did two things very early at the beginning of the outbreak of the pandemic.

It slashed rates to the floor (zero) and set in motion a massive bond-buying program in play (QE). This was a blanket reaction, which slashed the cost of liquidity and showered the system with lots of it. And this is a permanent liquidity addition. The Fed buys bonds from investors and credits them with cash, which then show up as reserves in the banking system. There are no winners or losers here. Rather there is an increase in the Fed's holdings of bonds and an increase in reserves in the system.

This is great, but there is a problem. Those reserves can in fact just sit there without being employed.

As the lockdown began to bite, many problems began to brew. Many of these problems revolved around getting access to liquidity, even though by definition there has never been as much liquidity available, ever. One of the first signs of pressure came from corporates that needed to get access to liquidity to fill gaps that had emerged due to the shutdown. They then drew on bank credit revolvers which placed some pressure on banks to supply liquidity. Typically this is not a big issue, provided there is not a call from every corporate at the same time. But there was a bit of that in play.

Many of the systemic problems revolved around getting access to liquidity, even though by definition there has never been as much liquidity available, ever

Many corporates needed more liquidity than revolvers or other sources could supply, and chose to liquidate some of their holdings in money market funds. The same logic holds here; this typically should be fine. But not if all done at once.

Money market funds then needed to find liquidity in order to meet a wider outflow trend, which would threaten a gates and fees freeze of the funds if the outflows became severe. This had to be prevented. Very easily, the dominos could have started to fall. The financial system is very interlinked, and each of these steps required attention, literally within days of the shutdown.

How the Fed began plumbing the system

Enter the Fed with a series of key facilities.

First, a backstop for money market funds where they could get access to liquidity from banks, and done in a way to minimise regulatory complications from the banks perspective. Money market funds could effectively tap into the liquidity that was being made available to the banking system, where banks could sponsor out a part of their balance sheet to be employed by money market funds that required liquidity to facilitate orderly outflows when they occur.

Complicating the picture was a virtual shutdown of other sources of liquidity, and crucially from primary market issuance of new

securities to the marketplace

That available liquidity is bolstered by an ongoing Fed repo facility that allows prime banks to post as much collateral as they like for as much liquidity they want. In addition, the Fed has made available a credit facility specifically for prime lenders, with a view to ensuring there is ample access to liquidity for the wider economy.

But just as one issue was addressed, more appeared, often simultaneously.

Complicating the picture was a virtual shutdown of other sources of liquidity, and crucially from primary market issuance of new securities to the marketplace. Critically, corporates found that they were locked out from issuing commercial paper. This is important, commercial paper programs are a corporate's easiest access to ongoing liquidity. With the commercial paper market shut, there was then additional pressure on bank revolvers and money market fund liquidations. And on it goes.

This was rapid-fire stuff from the Fed, all aimed at keeping the system afloat, while in the background equity markets were crumbling and high yield credit spreads exploding

With this in mind, the Fed set up a special purpose vehicle (SPV) to help fund issuers of commercial paper. The price of that was set at the risk-free rate plus 110bp, and 200bp for lower-rated players. Then the Fed overlaid this with a primary market corporate credit facility where a Fed SPV could either lend direct to corporates or buy corporate bonds, effectively as a private placement. And the Fed also added a secondary market element, where corporate bonds could be bought for maturities of up to five years.

This was rapid-fire stuff from the Fed, all aimed at keeping the system afloat, while in the background equity markets were crumbling and high yield credit spreads exploding.

Reasons for optimism, but stresses continue to crop up

This is a remarkable set of measures and massive but focused liquidity support. They were a big reason for the improvement in conditions seen a couple of weeks ago. Things have deteriorated since, but more on account of a changing market discount with respect to when the shutdown ends, and its long term impact.

As this played out, there were other wrinkles evident in the system. Mortgage REITs saw margin calls as mortgage-backed bonds come under widening pressure

One issue here however is that these three SPVs are not fully up and running as of yet. The knowledge that they will very soon does provide an important element of support. Until they do, however, the pressure remains elevated for both the banks and corporate credit spreads. And that in part explains why Libor has not shown a material fall (although it has at least stopped rising).

As this played out, there were other wrinkles evident in the system. Mortgage REITs saw margin calls as mortgage-backed bonds come under widening pressure, and many such REITs had to scramble for cash in order to make such calls. The Fed reacted in part by starting to buy mortgage-backed bonds, as part of their bond buying QE programme. It became increasingly evident that when the Fed came in with a new programme, there was most likely some significant stress front running this.

The off-shore dash for dollar liquidity

And there was also frantic dash for dollar liquidity from off-shore accounts in play. The dollar began to command a dramatic premium, so getting access to it became even more expensive. This manifested in an increase in the basis (extra cost) attached to \$Libor for players that wanted to swap from their own domestic currencies, like the euro or yen etc for dollars. To help ease this pressure, the Fed provided FX swap lines to other central banks so that off-shore dollar liquidity could be enhanced. This worked well.

In addition, the Fed provided a repo facility for global central banks and other monetary authorities. This helped to take the pressure off central banks that had been selling dollar reserves in order to get access to dollar liquidity. Instead, those central banks could post bonds at the Fed in exchange for dollar liquidity on a rolling 1-day basis. It also means that central banks that did not have access to the Fed's FX swap line could in the vast majority of cases have access to this repo facility.

And now we have an alphabet spaghetti of support

In addition, straight from its great financial crisis playbook, the Fed re-established support to enable the issuance of asset-backed securities backed by student loans, auto loans, credit card loans etc. In recent days, the official sector has been talking about support for the main street, and specifically the provision of credit support for small and medium-sized businesses. This last one is an important one given the stress seen in the small business sector in particular.

Phew, if you have made it this far then know that we have covered the following:

MMLF – Money Market Mutual Fund Facility

CPFF – Commercial Paper Funding Facility

PMCCF – Primary Market Corporate Credit Facility

SMCCF – Secondary Market Corporate Credit Facility

PDCF – Primary Dealer Credit Facility

TALF – Term Asset-Backed Securities Loan Facility

And on top of that are the other facilities such as the Fed's Repo window for primary dealers, the Discount window for wider financials, the Repo facility for central banks the, Fed's QE in Treasuries and mortgage-backed securities, and finally another credit aimed at main street which is imminent.

The numbers are huge

All of this should ease the pressure in the plumbing and in markets generally.

The alphabet of lending facilities above could easily end up being in the region of \$0.5trn to \$1.5trn apiece. The Fed's QE is already in excess of \$5trn and other liquidity avenues could easily cumulate to in excess of \$1trn. US GDP was \$22bn at end 2019. Contextualised against that, these are huge in size and should be effective in terms of influence. They need to be though, as they plug massive gaps left from the lockdown.

Moreover, most of these are mere plasters of the wound. The long-term healing process is far from certain.

Libor should fall, but needs some signs of stability

Cumulatively, these facilities should at the very least contain Libor, and in fact, should be enough to slowly bring it off its highs. The month of April will tell us as the Fed's SPV really kicks in.

The prognosis for high yield credit spreads is more troubled though, and that in turn is why any ease in Libor will be questioned and would be quite a tame if not pained retracement. We'd take that though.

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Will the Bank of England's commercial paper facility work, and how?

The Bank of England and HM Treasury launched the Covid Corporate Funding Facility (CCFF) last month to restore the functioning of the Sterling Commercial Paper (CP) market. The facility has the potential to shore up the CP market but access to lower or unrated companies remains a challenge



Source: Shutterstock

Main characteristics

The CCFF is buying 1 week to 12 month commercial paper from investment-grade (A-3/P-3 and above) non-financial issuers in the primary and secondary markets. The purchases will be financed by the Bank of England creating bank reserves (the same way quantitative easing is financed) while HM Treasury is the ultimate risk owner of the facility.

The purchase levels and amount eligible depend on the rating of the issuer and are summarised in the table below. This table is merely indicative and additional factors will be taken into account in setting lending limits, such as the issuers' revenue.

Indicative purchase level and limits

| Issuer Rating | Purchase spread to OIS | Initial issuer limit |
|---------------|------------------------|----------------------|
| A1/P1/F1/R1 | 20 bps | Up to £1bn |
| A2/P2/F2/R2 | 40 bps | Up to £600m |
| A3/P3/F3/R3 | 60 bps | Up to £300m |

Source: BOE, ING

The stated aim is to provide large firms with financing to bridge the disruptions created by the coronavirus pandemic and associated confinement measures. We would add to this that its aim is also to palliate dysfunctional money markets caught by surprise by the severity of the economic shock. [The Bank of England published a Q&A](#) with operational details of how to access the facility. The Association of Corporate Treasury has also published a [slide pack](#) with practical information.

How big can it be?

In our mind, the facility can be successful in two ways. In an ideal world, the mere announcement of a BoE-funded backstop to CP markets should be enough to restore confidence and normal functioning. This would be sufficient if the crisis were endogenous to the CP market, but we suspect the withdrawal of some investors was related to concerns about the underlying credit quality of the issuers, with outflows in the case of money managers, and with possible increases in issuer exposure from other factors (eg revolver credit facilities being drawn).

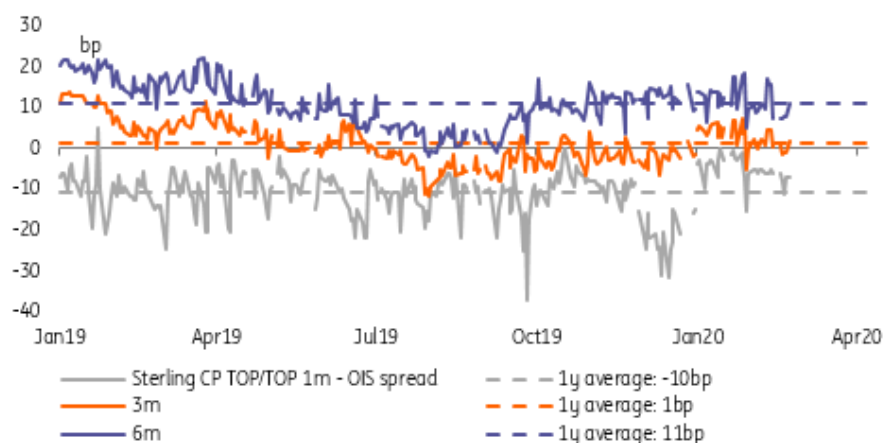
We hardly have any public real-time data on the amount of transactions that occurred in recent weeks, but we suspect CP volumes have plunged and failed to recover since the facility came on line in late March. One clue is that the top/top sterling CP index has not published values since late February. This index relates to top-rated issuers, the ones least likely to lose market access.

This leads us to the second way this programme can be successful: replacing the buyers that have fled the market altogether. The table above shows the maximum theoretical lending to each counterparty. Here too, the lack of data requires us to make assumptions about the number of beneficiaries. As a guide there are 90 issuers in the Bloomberg Barclays sterling corporate bond index that have currently more than one issue included in the index. Using their composite rating to estimate their maximum borrowing, we arrive at £54 billion. This compares with £1.9 billion lent so far via the facility. There are plenty of reasons why this estimate could prove wrong, most notably if companies that are not bond issuers decide to tap the CP market, but we think it provides a useful ballpark.

How much of an impact can it have?

Provided other investors return to the CP market alongside the BoE, CP rates should coalesce around the central bank's purchase levels. Judging from the 1m, 3m, and 6m TOP/TOP commercial paper level prevailing over the past year, the 20 basis point purchase spread over OIS for A-1 rated issuers is generous for long maturities and conservative for shorter ones. This should contribute to skewing issuance towards the longer tenors, in our view.

1m, 3m, and 6m top-rated CP-OIS spread in the past year

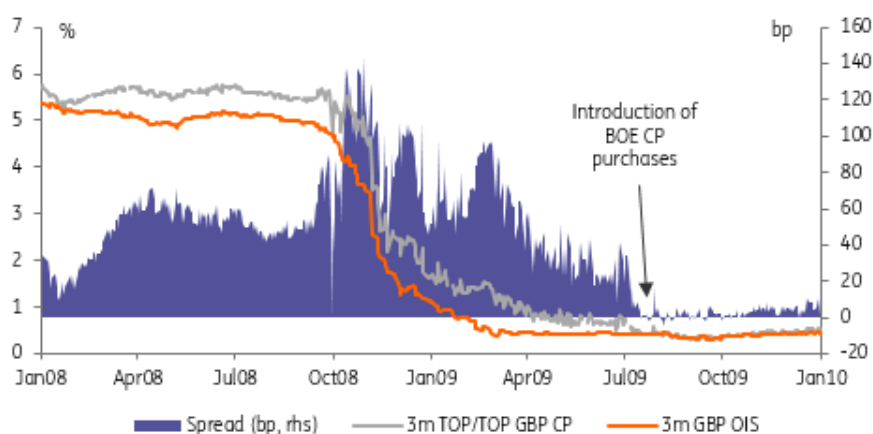


Source: Bloomberg, ING

Taking a few steps back, highly rated 3m CP have traded 43bp above to OIS on average in 2008-09 with peaks well above 100bp in 2008. Much has changed since then but in comparison, the BoE target levels seem designed to stem any aggressive widening of CP spreads, and therefore an increase in corporate funding costs. We would assume that £1bn hardly covers the cash needs of large corporations with a significant loss in revenue and in CP market access, however.

The historical precedent of the 2009 BoE CP purchases is interesting. At the time, holdings of CP peaked at £2.3bn and yet this coincided with a sharp tightening of CP spreads. Clearly, the BoE intervention had a strong signalling impact beyond the mere purchases it carried out, although they took place in 3Q 2009, when the worst of the financial stress was already over.

2009 CP purchases: a little too late



Source: Bloomberg, ING

International comparison

Another way to judge the parameters of the BoE CCFF is by comparing it to similar facilities put in place in other jurisdictions. The Federal Reserve's CPFF is the most relevant reference point in our view (not just due to the similarity of the acronym).

CPFF's purchase spreads of 100bp and 200bp over OIS for 3m CP appear a lot less generous than the BoE's. The UK programme also appears operationally more flexible as it will purchase CP across maturities whilst its US counterpart will focus only on the 3m tenor.

Another difference is on the limit of the programmes. Both have theoretically unlimited purchasing power but in the Fed's case, the aim is to cap purchases to the amount of CP issuers had outstanding prior to the coronavirus crisis. In the BoE's case, the limits clearly invite firms that were not necessarily participating in this market to use this facility.

Practical considerations and the future of CCFF

In conclusion, we think that the facility is a useful tool in the UK's policy arsenal but could benefit from improvements. Pricing and operational flexibility are two strong points. The wording of the announcement makes it clear that there should be no stigma attached to using it and that it could be considered a first line of defence for large corporates. We also assume that by its nature - short term loans - its use will not attract the same degree of public scrutiny as a bailout or direct government support.

Its exposure limit makes it more challenging for it to have an impact beyond top rated issuers, however. Clearly, lower-rated companies would benefit from greater purchases, but the limits suggest a reluctance to take on credit risk. We would also flag that, unlike other central banks, the BoE is already accepting A-3 rated CP.

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Spreads and future default rates

We believe that given the ING base case economic scenario containing a bounce back in economic activity in 3Q, spreads are more than fairly valued and we would be cautiously optimistic from here. This report is an abridged version released earlier for professional clients



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