

Dollar funding solutions get beefed up

Another weekend, another set of announcements from the Federal Reserve, and other key central banks. Last weekend the Fed took measures to protect deposits, and by implication solvency. They also beefed up access to liquidity for US banks. This weekend, it's about ensuring access to dollars outside of the US. Another safety net in place



Federal Reserve

Source: Shutterstock

The Federal Reserve has taken steps to ensure quick access to dollar liquidity, just in case

The Fed has announced late Sunday that “to improve the swap lines’ effectiveness in providing U.S. dollar funding, the central banks currently offering U.S. dollar operations have agreed to increase the frequency of 7-day maturity operations from weekly to daily”. So the key thing here is this is an existing facility, but it will now be accessible daily, starting on Monday (so straight away).

What does this facility achieve? Here’s the explanation from the Fed – “These swap facilities are designed to improve liquidity conditions in global money markets and to minimize the risk that strains abroad could spread to U.S. markets, by providing foreign central banks with the capacity to deliver U.S. dollar funding to institutions in their jurisdictions”. So bottom line, this allows central

banks to access US\$ from the Federal Reserve to help satisfy dollar liquidity needs outside of the US. The Fed does this to prevent negative externalities from infecting the US.

This comes in the wake of the weekend deal for UBS to buy the troubled Credit Suisse, which saves deposit holders, but not Tier 1 security holders. But the real object here is to save the system, or at a very minimum to help foster financial stability. The same central banks that are party to the Federal Reserves' US\$ swap line have all come out with positive statements on the solution agreed for Swiss banking (Swiss National Bank, Bank of England, Bank of Japan, Bank of Canada, and the European Central Bank).

It's a precautionary blanket measure, but does not solve all problems for individual banks

We view this increase in frequency of access to the US\$ swap line as precautionary. Last week there was no material evidence of outsized demand for US\$. Currently there is US\$470m drawn, practically all by the ECB. That's up from US\$390m a month ago, and it was in the US\$200m area for more of 2022. So, its use is up, but not significantly. Nothing compared to the usage in excess of US\$400bn seen when the pandemic broke, or over US\$500bn a decade-and-a-half ago during the Great Financial Crisis.

There is no indication that use of this facility will necessarily explode from here

There is no indication that use of this facility will necessarily explode from here. We'd often look to the basis on cross currency swaps as a guide for dollar funding stresses, as typically this would show through an increase in the US\$ premium. In fact, the deployment of this facility for the first time in 2007 was as a solution to dollar funding needs at that time, and it helped to reduce the dramatic premium attached to getting access to dollar liquidity back then. There had been some evidence of a larger US\$ basis premium last week, but it was quite mild.

Here, the Fed is getting in ahead of any problem with respect to US\$ access. It's purely being done to protect the plumbing of the system, just in case things take a turn for the worse in the days and weeks ahead. The move to daily central bank access to dollar liquidity will continue through to the end of April, so the Fed sees it as a temporary measure. It ensures that on any day where there is a dollar liquidity need, it will be met quickly. View this as a means to calming things, preventing the market from worrying on this front.

It does not solve banking problems though

It does not solve banking problems though. And the Fed's balance sheet is now being re-deployed again to help some banks – it rose by some US\$140bn last week (within which new bank measures increased it by US\$250bn). Some US\$150bn of liquidity was taken from the Fed's Discount window

through the week ended 15 March. This was the highest on record; even higher than the highs seen during the financial crisis. This is a means to ensuring access to dollar liquidity for domestic US banks.

The Fed will expect that these facilities (plus the new Bank Term Funding Program) will cater for all dollar liquidity needs, domestic and international. That's good. Last weekend the Fed made an effort to protect the solvency of the system by protecting the deposits of failed banks, and that protection then impliedly extended to all deposits following subsequent statements from various top officials, including the president. There are a lot of safety nets out there at this point.

The burning question is how weak are the weakest links, and how are they dealt with if they break. Silicon Valley Bank and Credit Suisse provide from some templates, and they have stories behind them, and rationales to suggest this is more idiosyncratic than systemic. That said, the solutions offered are clearly aimed to protect the system, just in case.

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 www.ing.com.