TREASURY ENDING SOME FED FACILITIES: IS IT MUCH ADO ABOUT NOTHING?

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The Treasury's announcement that it would end some of the facilities used by the Federal Reserve (Fed) in the wake of the pandemic-related market dislocations certainly caught observers by surprise. But it's also important to remember that the key funding market facilities (commercial paper funding, money market mutual fund and primary dealer credit) all remained in place with a 90-day extension. As we witnessed during the financial crisis and this year's March dislocations, the funding markets are where "the rubber meets the road" and the ability to garner short-term financing is crucial. The extension of these facilities achieves that.

In terms of the corporate and municipal bond buying facilities, the Fed's announcement of these programs was probably more effective for stabilizing the respective markets than the actual purchases themselves. Prior to the Treasury's announcement, U.S. investment-grade and high-yield spreads have recouped 97% and 90%, respectively, of their peak widening in March. Both of these facilities have seen rather marginal buying. In terms of the corporate bond facility, "only" $13.7 billion were actually purchased, and for munis, the number was even smaller, at $1.7 billion. To put this in perspective, the Fed's Treasury and mortgage-backed securities (MBS) is an eye-popping $6.6 trillion!

Conclusion

While the Fed expressed its disappointment, the policy makers still have a lot of facilities at their disposal. Remember, the corporate bond and municipal programs were new additions to their toolkit this time around and were not in use during the financial crisis—and the Fed did just fine without them.

Unless otherwise stated, data source is Bloomberg, as of 11/20/2020.

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Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Corporate Bonds : a debt security issued by a corporation.

Municipal Bond : A debt security issued by a state, municipality or county to finance its capital expenditure.

Investment grade : An investment grade is a rating that signifies a municipal or corporate bond presents a relatively low risk of default.

High Yield : Sometimes referred to as “junk bonds,” these securities have a higher risk of default than investment-grade securitie.

Mortgage-backed spreads : represents spreads on mortgage-backed securities. Spread represents the portion of the bond’s yield that compensates investors for taking on additional risk over a benchmark security with a similar maturity profile.