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QE Unlimited and Corporate Credit Facilities

Fed special

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Contents

Summary

- Today, the FOMC expanded its large scale asset purchase program by promising to purchase 'in the amounts needed.' Previously, the FOMC had said it would purchase at least $500bn of Treasury securities and at least $200bn of agency MBS. The FOMC also announced that the agency MBS purchases will include agency commercial MBS.
- The Fed also made CPFF more generous in terms of pricing and opened CPFF and MMLF to a wider set of assets.
- The Board of Governors relaunched the Term Asset-Backed Securities Loan Facility (TALF), providing loans in exchange for ABS.
- Two novel facilities are the Primary Market Corporate Credit Facility (PMCCF) and the Secondary Market Corporate Credit Facility (SMCCF). We are likely to see an increased contribution by the Treasury Department to these facilities once the big fiscal stimulus has been signed.
- In its press release, the Fed also said it expected to announce soon the establishment of a Main Street Business Lending Program to support eligible small-and-medium sized businesses. This may also be linked to the fiscal stimulus.

Introduction

While we are still waiting for the third and largest corona-related bill from Capitol Hill, the Fed took the next steps in supporting the markets and the economy today. While the FOMC expanded its large scale asset purchasing program by basically indicating that there will be no upper bound, and by including agency commercial MBS, the Board of Governors relaunched TALF to support ABS issuance and established two novel corporate credit lending facilities.

QE Unlimited

When the FOMC announced its large scale asset purchase program on March 15, it only gave a lower bound for the amount of purchases: at least $500bn of Treasury securities and at least $200bn of agency MBS. Today the Committee basically said that there will be no upper limit: it twill purchase 'in the amounts needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy.' So we may call this large scale asset purchase program 'QE Unlimited' now, even though Powell was even hesitant about calling it QE during the conference call on March 15. In addition to removing any upper bound to the asset purchase program, the FOMC also announced that it would include agency commercial MBS to its purchases of agency MBS under the program.

The resurrection of TALF

As we described in Alphabet Soup, there were still a number of special lending facilities from the previous crisis that had not yet been relaunched by the Fed. Today, the Board of Governors brought TALF back to life, the Term Asset-Backed Securities Loan Facility. The Fed will lend through a special purpose vehicle (SPV) on a non-recourse basis to holders of certain AAA-rated ABS backed by newly and recently originated consumer and small business loans. The Treasury Department will make a $10bn equity investment in the SPV using the Exchange Stabilization Fund (ESF). TALF is aimed at supporting the issuance of ABS backed by student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration (SBA), and certain other assets. The loans under TALF will have a maturity of 3 years.

Introducing PMCCF and SMCCF

Two novel facilities are the Primary Market Corporate Credit Facility (PMCCF) and the Secondary Market Corporate Credit Facility (SMCCF). Like TALF, they were established under the authority of Section 13(3) of the Federal Reserve Act, which is a 'unusual and exigent circumstances' clause, with the approval of the Treasury Secretary. The PMCCF is aimed at new bond and loan issuance, while the SMCCF provides liquidity for outstanding corporate bonds.

The PMCCF will make loans to investment grade US companies, providing bridge financing of four years through an SPV. The Treasury Department will make an initial $10bn equity investment in the SPV using the ESF. Borrowers at the PMCCF may elect to defer interest and principal payments during the first six months of the loan, extendable at the Fed's discretion, in order to have additional cash on hand that can be used to pay employees and suppliers. The SMCCF will purchase, through an SPV, investment grade US corporate bonds and related ETFs in the secondary market. The Treasury Department will make an initial $10bn equity investment in the SPV using the ESF.

Note the word 'initial' used when the Fed described the Treasury equity investments in PMCCF and SMCCF: we may see larger contributions from the Treasury once the big stimulus bill has been approved by Congress and signed by the President. The current contributions from the Treasury Department come out of the Exchange Stabilization Fund. The two corporate credit facilities will continue until September 30, 2020, unless the facilities are extended by the Board of Governors.

The novelty of these programs shows that this crisis is different from the previous one. Last time the problems started in the financial sector, while this time the real economy is getting a hit from the coronavirus and non-financial businesses are facing enormous cashflow problems. Note that the corporate credit facilities are open only to investment grade companies, so lower rated firms are still on their own as far as the Fed is concerned.

Tweaking CPFF and MMLF

In addition to launching three special lending facilities, the Board of Governors also tweaked two recently launched lending facilities: CPFF and MMLF. The Fed made the Commercial Paper Funding Facility (CPFF) cheaper by reducing the pricing to 3 month OIS plus 110 bps instead of 200 bps. The old pricing of 3 month OIS plus 200 bps now applies to commercial paper that was rated A1/P1/F1 on March 17, but was subsequently downgraded to at least A2/P2/F2. The Fed also included high-quality tax-exempt commercial paper. The Money Market Mutual Fund Liquidity Facility (MMLF) now includes a wider range of securities, including municipal variable rate demand notes (VRDNs) and bank certificates of deposit.

What’s next?

In its press release, the Fed also said it expected to announce soon the establishment of a Main Street Business Lending Program to support eligible small-and-medium sized businesses. This may also be linked to the fiscal stimulus. Two special lending facilities that have yet to make a comeback are the ‘auction-equivalents’ of the discount window and PDCF: TAF and TSLF. Also, we may see additional USD liquidity swap lines with a wider set of central banks. For more details and an overview of the various special lending programs we refer to Alphabet Soup. Finally, the FOMC could also provide stronger forward guidance regarding the federal funds rate.

Table 1: Rabobank forecast of federal funds rate path

FOMC meeting	*Decision*	*Target range for the federal funds rate (%)*
29 Jan 2020		1.50-1.75
3 Mar 2020 (Emergency meeting)	50 bps cut	1.00-1.25
15 Mar 2020 (Emergency meeting)	100 bps cut	0.00-0.25
22 March 2020 (Emergency meeting)		0.00-0.25
29 Apr 2020		0.00-0.25
10 June 2020		0.00-0.25
29 July 2020		0.00-0.25
16 Sept 2020		0.00-0.25
5 Nov 2020		0.00-0.25
16 Dec 2020		0.00-0.25

Source: Rabobank

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