FED TO INCREASE LIQUIDITY INJECTIONS SIGNIFICANTLY

In direct response to what the Fed identifies as “highly unusual disruptions in Treasury financing markets associated with the coronavirus outbreak,” the Fed announced today a significant increase in its infusion of liquidity into financial markets, including $60bn of reserve management purchases across “a range of maturities to roughly match the maturity composition of Treasury securities outstanding.” This shift toward significantly larger liquidity infusions into short-term repo operations and much broader Treasury management purchases ramps up the size of the Fed’s balance sheet dramatically and takes on characteristics of quantitative easing.

The Fed is increasing its short-term funding operations significantly: the operating desk of the New York Fed will continue to offer its existing overnight and two-week repo operations, but it will further offer $500bn in three-month repo operations and $500bn in one-month repo operations. This is aimed specifically at making sure there is ample liquidity in short-term funding markets over the next month to facilitate smooth functioning of financial markets and to address liquidity shortages and dampen undesired volatility.

In addition, the Fed will initiate purchases of $60bn across eleven sectors, including nominal coupons, bills, Treasury Inflation-Protected Securities (TIPS), and Floating Rate Notes, with the same maturity composition of Treasury securities outstanding. That is, it will be conducting asset purchases in longer duration Treasury securities.

This aggressive asset-purchasing program in an array of maturities is the second emergency measure taken by the Fed in the last week.

The Fed is very aware that the coronavirus and its negative economic fallout is a health crisis that cannot be addressed through monetary easing. However, in the last week, the dramatic deterioration in the corporate bond market and clear signs of illiquidity raised the Fed’s concerns that the negative health care shock was evolving into a potential financial crisis. For these reasons, the Fed acted aggressively.
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