Weekly Market Summary

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Bailing Out The World: Printing Money From Thin Air
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Latest Update on Coronavirus: Confirmed cases topped 1 million (last at 1,026,688 versus 542,533 last Friday), 54,045 deaths (versus 24,369). The COVID-19 is now affecting 204 countries and territories around the world (versus 199 last week). Some epidemiologists have predicted a peak in global coronavirus cases by late April. As the most infected country, the US, remains on an exponential path of new daily cases. Meanwhile, the most infected European nations, i.e., Italy, Spain, Germany and France, registered lower daily new cases than their respective peaks. However, France registered the largest daily rise in deaths of any country. US intelligence accused China of playing down crisis believing China has been underreporting the total number of cases and deaths. Mr. Trump announced he was invoking the Defence Production Act, a 1950s law, to help shore up dwindling supplies of masks and other supplies. The UK will test 100,000 per day for the virus by the end of the month and Philippines President orders police and military to kill citizens who defy coronavirus lockdown!

This week, The Federal Reserve said it would launch a temporary lending facility that for the first time will allow foreign central banks to convert their holdings of Treasury securities into dollars, its latest bid to alleviate strains in global markets. The program could allow around 170 foreign central banks and other international monetary authorities that maintain accounts at the New York Fed and aren't subject to U.S. sanctions to enter a lending arrangement called a repurchase agreement, or repo, in which borrowers temporarily exchange their Treasury securities for dollars.

The Fed introduced this temporary emergency liquidity providing facility following a spike in sales of US Treasury's by foreign institutions (i.e., central banks and reserve managers) as governments are thirsty for dollars to fund their payments and oil-exporters are forced to liquidate assets following the slump in oil prices. The new repo program "is a sensible second-best solution for major countries that are outside the enlarged Fed FX swaps network but have substantial corporate dollar funding needs," said former NY Fed spokesman Krishna Guha.

One look at the Treasury securities held in custody at the Fed shows that the past two weeks have seen a whopping $50BN in foreign central bank sales, a 1.7% drop which was the highest in six years. In total, in the turbulent month of March, Treasury's held in custody at the Fed on behalf of foreign central banks, sovereigns and reserve managers dropped by a record $109 billion - the biggest monthly drop in history.

To note, the Fed has been on QE mode for quite a while now. It started pumping up its balance sheet in October, with chairman Jerome Powell insisting that such activity should not be seen as another round of QE. It was purchasing $60 billion of short-dated Treasury bills every month in addition to pouring billions of dollars of cash into the repo market. Last month, following the wake of the coronavirus pandemic, it instituted QE5 by announcing the purchase of $700 billion worth of Treasuries and mortgage-backed securities. It then moved to QE infinity (and maybe beyond that!) last week. It noted it will buy an unlimited amount of government debt, as well as corporate and municipal bonds, saying they will be "in the amounts needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy".

If the Fed continues QE at the current pace of $625 billion per week, the Fed's balance sheet will hit $10 trillion by June, or just below 50% of US GDP. Even assuming the Fed eases back of the gas pedal, its balance sheet is almost certain to hit $7 trillion by June (already at a historic record of $5.81 trillion by week ended April 1). In addition, the Fed buying investment grade (IG) corporate bonds could soon nationalize the stock market. With the economic shutdown, IG companies will continue to issue *bonds for liquidity needs while others frontload as the market is wide open. The Fed could very soon end up owning equity stakes in hundreds of bankrupt companies once its bonds are equitized as dozens of formerly IG companies are downgraded to junk, and then file for bankruptcy, converging the pre-petition debt into equity.*

Despite the sweeping measures taken by the Fed, the hunger for dollars remains and the cost of funding it kept creeping higher earlier in the week until slightly easing the past two days. The recent turbulence in U.S. dollar funding markets was in part the result of a decrease in bank hedging services because of rising volatility, according to a paper by the Bank for International Settlements published Wednesday. Three-month dollar Libor fell 1.4 basis points on Wednesday, and 6 bps on Thursday. The yield on short-term commercial paper issued by top-tier non-financial companies fell to 1.51% as of March 31, according to Fed data published Wednesday. Yet any commercial paper that issuers are selling are still concentrated among the shorter tenors, an indication the market is still relatively frozen. This is why the debut of the central bank's Commercial Paper Funding Facility -- due to start in the first half of April -- will be important to watch.

While the need for dollars has been causing disruptions in the bond market, Trump tweets these two days took oil markets on a rollercoaster ride (investors not sure if they should buy the dip or sell the news ☺). Oil futures rallied Thursday, sending U.S. prices up by nearly 25% and Brent by nearly 40% as he tweeted that he expects Saudi Arabia and Russia to reach an agreement to significantly cut production. Trump tweeted that he expects a cutback of "approximately 10 Million Barrels, and maybe substantially more." He later tweeted that it could be as high as 15 million barrels. Only a few hours later, this morning, oil prices shed those gains as doubts over a deal grew. It certainly won't be easy for Riyadh and Moscow to agree on such a big cut, just about a month after they had fought over a cut of 1.5 million. Nevertheless, 2020 has been a year of shocks in all aspects, and with OPEC+ now agreeing to meet on Monday, we will have to just wait and keep hopes high.

Last but not least, the American job market has been battered with 6.6 million US workers filing for their first week of unemployment benefits in the week ending March 28, according to the Department of Labour — a new historic high. First-time claims for unemployment benefits have surged more than 3,000% since early March. Including the prior week's 3.3 million initial claims, Americans have filed nearly 10 million jobless claims in the last two weeks alone. That corresponds to roughly 6% of America's 165 million strong work force, which in turn implies a 9.5% unemployment rate. With large parts of the US now on lockdown, millions of people working in retail, restaurants, travel, hotels and leisure industries have lost their jobs and the losses are spreading. Oil and gas companies are laying off workers as oil prices collapse and engineering firms including General Electric are cutting staff as the airline industry grinds to a halt. All eyes will be on today's March jobs report released (3:30 pm Bahrain Time). Estimates for the March change in non-farm payrolls span a wide range, with a handful of firms anticipating payrolls actually rose modestly at the start of the month. But at the median, economists anticipate payrolls netted out to -100,000, reflecting the first drop in nonfarm payrolls since September 2010. That would be a marked reversal after the economy grew payrolls by 273,000 in both February and January of this year. Unemployment rate is expected to rise to 3.8% from 3.5% in February, and the month on month average hourly earnings is expected to rise by 0.2% compared with 0.3% in February.

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