

Daiwa's View

Things to watch for in 2020: Part 5

- Will New York Fed continue to inject liquidity?

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Daiwa Securities Co. Ltd.

Will New York Fed continue to inject liquidity?

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Yesterday, US stocks again set record highs. As both the US and Iranian leaders intend to avoid letting the situation deteriorate further, market participants appear to have concluded that there is limited possibility that the tension will escalate even if sudden skirmishes occur. Partly due to a decline in the VIX Index, it can be seen that the caution in the financial market has eased. In such a situation, an interesting point is that US yields fell by 2-3bp across the curve last night. The 10-year Treasury yield also declined again to 1.85%, but this is, of course, not a flight to quality as the caution about the US-Iran situation has abated.

One background factor would be the impact of liquidity injection by the New York Fed. In September 2019, the repo market became largely dysfunctional, triggering re-expansion of the Fed's balance sheet and an increase in liquidity supplied to the repo market. This was explained in [our 18 November 2019 report Another factor behind risk-on mode](#). At that time, a preventive injection of large-scale liquidity was conducted to ensure the supply of funds around the turn of the year. However, it has eventually become apparent that such liquidity will remain without being collected even after the start of the new year.

Chart: Schedule of Overnight and Term Repurchase Agreement Operations

OVERNIGHT OPERATIONS DATES		AGGREGATE OPERATION LIMIT	
Friday, 12/13/2019 – Monday, 12/30/2019		At least \$120 billion	
Monday, 12/30/2019 one-day forward settlement repo*		At least \$75 billion	
Tuesday, 12/31/2019** – Thursday, 1/2/2020		At least \$150 billion	
Friday, 1/3/2020 – Tuesday, 1/14/2020		At least \$120 billion	
TERM OPERATION DATE	MATURITY DATE	TERM	AGGREGATE OPERATION LIMIT
Monday, 12/16/2019	Friday, 1/17/2020	32-days	At least \$50 billion
Tuesday, 12/17/2019	Monday, 12/30/2019	13-days	At least \$35 billion
Thursday, 12/19/2019	Thursday, 1/2/2020	14-days	At least \$35 billion
Monday, 12/23/2019	Tuesday, 1/7/2020	15-days	At least \$35 billion
Thursday, 12/26/2019	Thursday, 1/9/2020	14-days	At least \$35 billion
Monday, 12/30/2019	Tuesday, 1/14/2020	15-days	At least \$35 billion
Thursday, 1/2/2020	Thursday, 1/16/2020	14-days	At least \$35 billion
Tuesday, 1/7/2020	Tuesday, 1/21/2020	14-days	At least \$35 billion
Thursday, 1/9/2020	Thursday, 1/23/2020	14-days	At least \$35 billion
Tuesday, 1/14/2020	Tuesday, 1/28/2020	14-days	At least \$35 billion

Source: Extracted from New York Fed website.

This was probably influenced by the fact that demand exceeded the supply volume in operations on 7 January. Last year, the New York Fed prepared exhaustively for a supply of funds past the end of the year, mainly via 42-day term operations starting on 25 November (maturity date of 6 Jan, \$25bn), 28-day term operations on 9 December (6 Jan, \$25bn), and 15-day term operations on 23 December (7 Jan, \$35bn). Alongside the arrival of the maturity dates, however, the possibility has been exposed that support is necessary for the market. The authorities thus intend to cope with this situation.

Given the aforementioned condition, there is a possibility that the preventive supply of liquidity, which was initially conducted to avoid disruption at the end of the year, will be prolonged more than expected. In addition, expansion of the balance sheet at the New York Fed has an economic effect similar to quantitative easing, irrespective of its intention, thereby leading to “buying all kinds of financial assets.”

If the liquidity issue is a long-term and fundamental one, rather than an end-year issue, asset purchase operations that have been conducted since 15 October 2019 [as directed by the FOMC](#) may also be prolonged, although such operations may end in 2Q 2020 at the earliest. This is probably one of the background factors behind yesterday's decline in the US long-term yield even without reaching 1.9%, amid US stocks setting record highs. We can say that a liquidity injection by the New York Fed has become a major point to watch for also in 2020.

◆ **New York Fed (11 Oct 2019)**

- The Federal Open Market Committee (FOMC) directed the Desk, effective October 15, 2019, to purchase Treasury bills at least into the second quarter of next year to maintain over time ample reserve balances at or above the level that prevailed in early September 2019.

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■ Credit Rating Agencies

[Standard & Poor's]

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[Moody's]

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[Fitch]

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