Money Markets

Government Responds with Extraordinary Measures

Kerry Pope, CFA
Institutional Portfolio Manager

KEY TAKEAWAYS

- Extraordinary monetary and fiscal support is helping to inject liquidity in the market and restore confidence following widespread economic disruptions caused by the COVID-19 virus.
- Federal Reserve rate cuts and the strong inflows into government money market funds have caused rates to slide at the front end of the yield curve, but the influx of about $1 trillion in Treasury bills to pay for part of the CARES Act stimulus package are likely to benefit money markets and lift rates higher.
- However, all of the stimulus measures may only soften the economic blow from the virus, which has already impacted many industries; consumer spending and the jobs market are likely to set the course for recovery.
- Assets in government money market funds have surged as investors have sought safety in response to the uncertainty.

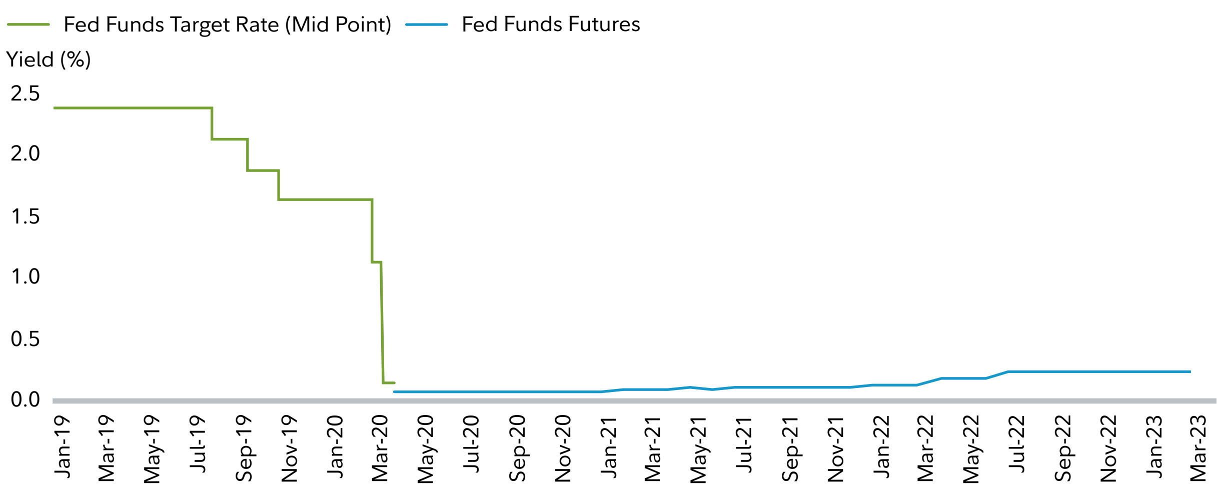
Unprecedented steps to address COVID-19

The Federal Reserve, the Treasury Department, and Congress have taken dramatic steps to counteract the effects of the COVID-19 virus on the economy. The Fed lowered the fed funds rate by a total of 1.50% at two unscheduled meetings of the Federal Open Market Committee (FOMC) in March, leaving the target range at 0%–0.25%. The midpoint of the target range has fallen dramatically as of March, with fed funds futures pointing to near-zero rates for the remainder of 2020, and muted increases thereafter (Exhibit 1). In addition to cutting rates to levels not seen since 2015, the Fed extended asset purchases and rolled out a number of facilities and programs to help support the flow of credit to households and businesses (Exhibit 2).

Meanwhile, Congress unveiled the $2.2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act with a range of spending, tax relief, and business support for the broader economy. The CARES Act includes about $450 billion for the Treasury Department's Exchange Stabilization Fund (ESF) for emergency reserves, which will allow the Fed more purchasing power to provide credit to large employers, liquidity for outstanding bonds, and loans for small businesses. Many states have asked for all but essential businesses to close down through at least the end of April, which has essentially shut down the U.S. economy. Recession is likely to be inevitable and would be the sharpest contraction since the 1950s.

Fed Chairman Jerome Powell noted that the U.S. economy had been on solid footing before the virus hit, and that policymakers were taking all necessary steps to support American families, businesses, and the economy overall.[1] As of this writing, equity markets were fighting back from steep losses, while global bond yields fell significantly during the quarter, with the yield on the benchmark 10-year U.S. Treasury falling below 1% for the first time in history. Weekly jobless claims hit a peak of about 6.6 million as furloughs and layoffs have impacted most industries, with travel and hospitality hit especially hard. Plummeting March data from the Purchasing and Managers Index (PMI) suggests sharp declines in manufacturing and services sectors. Earnings downgrades have emerged, with 2020 earnings-per-share (EPS) growth averaging -1.0%—which, given the current environment, may be optimistic. Homebuilder sentiment dipped significantly in March, in a sign that even hardy real estate will feel the impact of the virus. A steep drop in oil and reduced demand from the economic shutdown could add to disinflationary forces in the near term.

EXHIBIT 1: Interest rates were cut dramatically at two emergency meetings of the FOMC, while fed fund futures point to near-zero rates for 2020 and beyond.



Source: Bloomberg Finance LP as of April 17, 2020.

EXHIBIT 2: The Fed has undertaken significant actions to promote liquidity and ease bank lending for individuals and businesses, similar to steps taken in 2008.

FEDERAL RESERVE LIQUIDITY PROGRAMS		
FACILITY	PURPOSE	SIMILAR ACTION IN 2008?
Central Bank Swap Lines Extended	Unlimited USD swap lines with the 5 major central banks (ECB, BoJ, BoE, SNB, Bank of Canada). Maximum swap line of $60bn extended to the central banks of South Australia, Brazil, Mexico, Singapore, South Korea and Sweden. Maximum swap line of $30bn extended to the central banks of Denmark, New Zealand and Norway. Overnight and 84 day maturities available at a cost of OIS+25 bps.	YES
Commercial Paper Funding Facility (CPFF)	Bank, non-bank and municipal issuers of 3-month commercial paper can issue CP (via the primary dealers) to the Fed for a fee of OIS+110 bps for A1/P1 rated issuers and OIS+200 bps for subsequently downgraded issuers rated A2/P2. The Fed can purchase up to $100bn, using the ESF backstop provided by the Treasury at $10bn.	YES
Discount Window Rate Decreased	Discount rate (the rate the Fed charges on overnight loans to banks) decreased to 0.25% to help banks meet demands for credit from households and businesses. Traditional lender of last resort program for banks.	YES
Foreign and International Monetary Authority (FIMA) Repo Facility	Allows foreign central banks and other international monetary authorities to enter into repo agreements with the Fed using Treasuries in return for USD funding; helps ease strains in global USD funding markets.	
Money Market Mutual Fund Liquidity Facility (MMLF)	Allows prime and municipal money funds to sell CP, CDs and short-term municipal securities to depository institutions, which then finance it at the Fed using the assets as collateral. 125 bps funding cost for prime assets and 50 bps for municipal securities. Non-recourse loan to banks, so these assets are excluded from the leverage and RWA capital ratios.	YES
Open Market Operations (OMO)	Treasury and mortgage-backed security purchases extended to include commercial MBS. Provides temporary financing of collateral and reserve expansion.	YES
Paycheck Protection Program Liquidity Facility (PPPLF)	Fed will provide funding collateralized with PPP loans at a cost of 35 bps that are backstopped by the Small Business Administration. The PPP provides funds to small businesses to cover payroll costs.	
Primary Dealer Credit Facility (PDCF)	Fed provides loans of up to 90 days to primary dealers, collateralized by broad range of investment grade debt and a broad range of equities.	YES
CREDIT MARKET PROGRAMS		
Main Street New Loan Facility (MSNLF) and Main Street Expanded Loan Facility (MSELF)	Fed purchases 95% of a 4-year SME loan extended by a bank. Bank retains 5% of the loan. Borrowers subject to conditions as outlined in the CARES Act. Fed can purchase up to $600bn, backstopped by Treasury ESF.	
Municipal Liquidity Facility (MLF)	Fed will buy up to $500bn of short-term municipal debt from municipal issuers at market pricing+10 bp fee. Will provide a $35bn equity investment into the MLF SPV.	
Primary Market Corporate Credit Facility (PMCCF)	Fed will buy corporate bonds directly from the issuer or through a syndicated issue. Issuers must be rated investment grade or if recently downgraded, need to have been rated investment grade until March 22. Market pricing+100 bps fee. Treasury will make a $50bn equity investment in the PMCCF SPV.	
Secondary Market Corporate Credit Facility (SMCCF)	Fed will buy eligible corporate bonds and ETFs in the secondary market. Same guideline on ratings as above for corporate bonds. In addition to investment grade, high yield ETFs may also be purchased. Purchases at market pricing. Treasury will make a $25bn equity investment in the SMCCF SPV.	
Term Asset-Backed Securities Lending Facility (TALF)	Fed will provide up to 3 year loans collateralized with newly issued ABS. CLOs and legacy CMBS included. Treasury will make a $10bn equity investment in the TALF SPV.	YES
OTHER FED ACTIONS		
Emergency meetings of the Federal Open Market Committee (FOMC)	Unscheduled cuts of the fed fund rate totaling 1.50%, bringing the target range to 0%–0.25%.	YES
Loan Modifications	Encourages bank loan modifications for borrowers who are unable to make payments due to COVID-19 hardships.	
Capital and Liquidity Buffers	Encourages banks to use capital and liquidity buffers.	
Bank Reserve Requirement Reduction	Reserve requirements reduced to zero to support lending to households and businesses.	YES

Source: Barclays U.S. Money Markets, Fidelity Investments and Federal Reserve as of April 17, 2020.

Conditions are changing so rapidly that the FOMC decided to postpone until June its quarterly forecast for GDP, inflation, and employment in its Summary of Economic Projections (SEP). However, James Bullard, president of the Federal Reserve Bank of St. Louis, said recently that unemployment could hit 30% in the second quarter, while GDP could decline by 50%.[2]

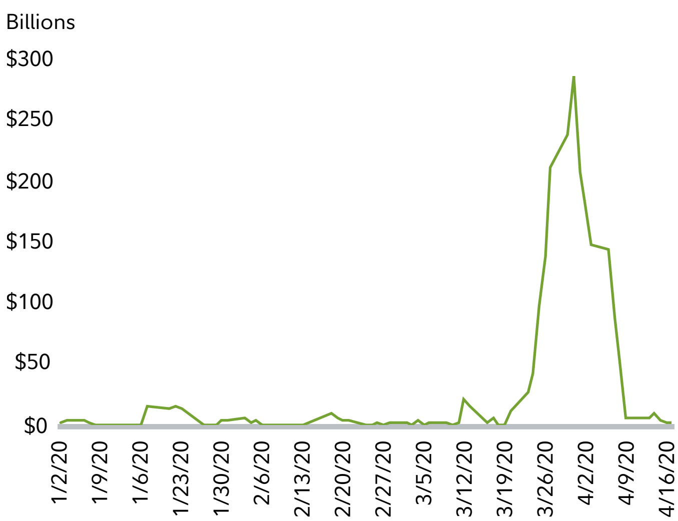
The combined monetary/fiscal infusion, representing approximately one-third of U.S. GDP, is likely to soften the impact of the virus but may not be able to prevent an economic contraction. In addition, there may be implementation delays in getting cash and loans to businesses and American families, which could impact how long it will take for the economy to start showing signs of improvement. The labor market and consumer spending are likely to be drivers in the recovery, but job losses and consumer confidence will take time to rebound. In China, for example, which has begun to see the number of new cases decline, consumers have remained reticent to return to their normal spending behaviors.

Fed rate cuts impact the market

The combination of Fed rate cuts and strong inflows into government money market funds have resulted in lower yields in the short end of the yield curve. Participation in the Fed's reverse repo program (currently priced at 0%) has increased significantly as demand from government money market funds has exceeded the amount of available dealer repo. Daily volumes of the Fed's reverse repo program climbed from just over $1 billion to a peak of $284.9 billion at the end of March (Exhibit 3). The effective federal funds rate (EFFR) has fallen to 0.05%, just 5 bps above the lower end of the Fed target range. The Fed may consider making a small upward adjustment to

EXHIBIT 3: Participation in the Fed's reverse repo program increased significantly in March as government money market inflows outpaced repo supply.

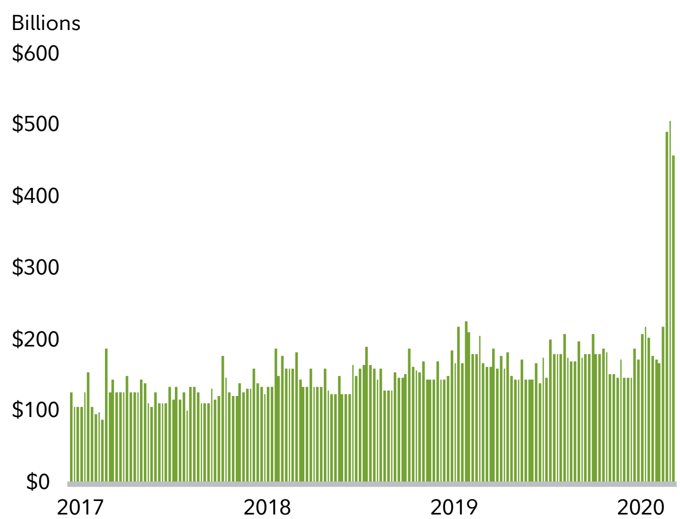
Federal Reserve Repurchase Agreement Facility Utilization



Source: Federal Reserve Bank of New York and Bloomberg Finance LP as of April 17, 2020.

EXHIBIT 4: Treasury bill supply has risen sharply, with weekly issuance hitting a high of $509 billion in April, the highest level since 2008.

Weekly Treasury Bill Gross Issuance



Source: U.S. Treasury, Wrightson ICAP, as of April 17, 2020. Includes regular series bills and cash management bills.

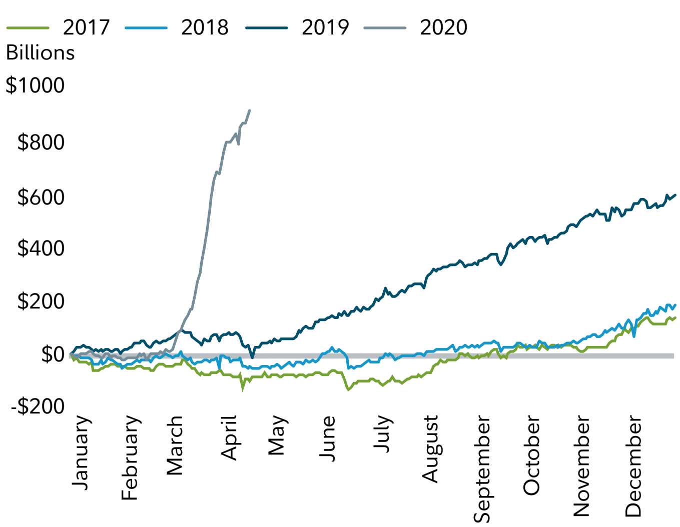
the interest rate on excess reserves to move the fed funds rate more toward the center of its target range. More recently, the influx of new Treasury financing as part of the CARES Act is helping lift short term rates. Treasury bill supply has increased significantly with the weekly issuance of Treasury bills hitting a high of $509 billion in April and the highest level since 2008 (Exhibit 4).

Money markets funds experience asset growth, declining yields

Assets have increased dramatically in government money market mutual funds amid the market volatility as investors sought safety. Cumulative growth in taxable money market funds (government and Treasury) increased to $918.8 billion as of mid-April (Exhibit 5). Conversely, prime money market mutual funds have seen outflows as investors have shifted into government money market funds (Exhibit 6).

EXHIBIT 5: Cumulative growth in taxable money market funds was significant in March alone, and much higher than in each of the previous three years.

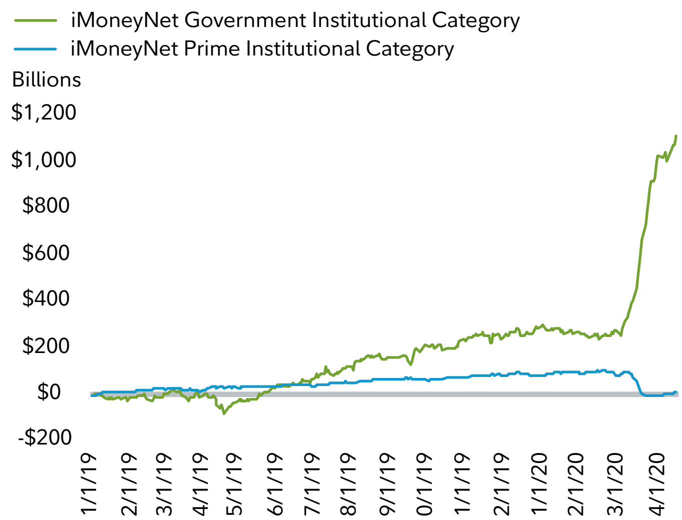
Cumulative Growth of Taxable Money Market Funds



Source: iMoneyNet as of April 17, 2020. Includes institutional and retail share classes.

EXHIBIT 6: Institutional prime funds saw steep declines in the first quarter as large investors sought to reduce their market exposure.

Cumulative Change in Assets

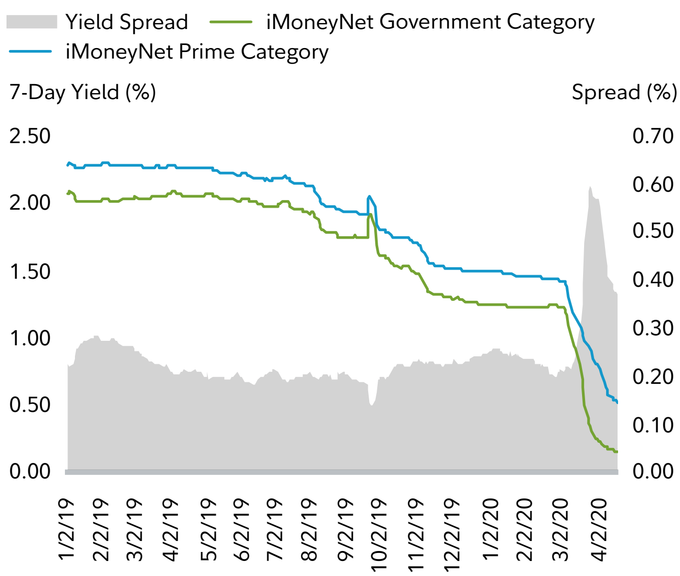


Source: iMoneyNet as of April 17, 2020.

With the Fed's move to zero rates and its new programs pumping liquidity into the markets, money market fund yields trended lower. Net yields on government money market funds fell to 0.13% as of mid-April, while net yields on prime funds fell to 0.49% in the same time period (Exhibit 7). The widening of yield spreads between government and prime funds is common during periods of market volatility as liquidity remains high for government securities but can be more challenging for credit securities. The Fed's Money Market Mutual Fund Liquidity Facility (MMLF) has helped improve the liquidity for high quality credit instruments such as certificates of deposit (CDs), commercial paper and asset-backed commercial paper, and municipal variable rate demand notes (VRDNs).

Municipal money market funds also experienced volatility in March. Yields on the SIFMA Municipal Swap Index increased from 1.28% to 5.20% and dealer inventories of short term municipal securities surged to about $30 billion. More recent inflows into municipal money market funds and improved liquidity

EXHIBIT 7: Yields on government and prime money market funds fell significantly in March.



Source: iMoneyNet, as of April 17, 2020. Includes both institutional and retail shares.

in municipal securities, partly due to the Fed's MMLF, have reversed this trend. The weekly SIFMA index has since contracted to 36 bps as of April 15. The building demand for municipal securities may well result in the continuing trend lower of municipal MMF yields.

Fidelity money market funds—well positioned

Fidelity's money market funds continue to provide security and safety for our customers' cash investments. As part of its conservative approach, Fidelity announced a soft close on three of its Treasury only and Treasury money market funds to new clients effective March 31. With the recent reduction in the federal funds rate and yields on Treasury securities at historic lows, Fidelity believes that limiting inflows into the Treasury money market funds will help preserve the returns of existing fund shareholders. Restricting inflows will help reduce the number of new Treasury securities that the funds will need to purchase. Existing shareholders may add to their accounts and there are no restrictions or limitations on redemptions for any shareholders.

Author

Kerry Pope, CFA
Institutional Portfolio Manager

Kerry Pope is an institutional portfolio manager in the Fixed Income division at Fidelity Investments. In this role, he is responsible for communicating portfolio strategy and positioning, designing customized liquidity-management solutions for institutional clients, and providing portfolio reviews.

Fidelity Thought Leadership Vice President Martine Costello provided editorial direction for this article.

Endnotes

[1] *U.S. Federal Reserve press conference of unscheduled meeting on March 15, 2020. https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20200315.pdf*

[2] *Source: Bloomberg Finance LP, March 23, 2020. https://www.bloomberg.com/news/articles/2020-03-22/fed-s-bullard-says-u-s-jobless-rate-may-soar-to-30-in-2q*

[3] *Securities Industry and Financial Markets Association, as of April 15, 2020.*

Information in this article is as of April 20, 2020 unless otherwise noted.

Unless otherwise disclosed to you, any investment or management recommendation in this document is not meant to be impartial investment advice or advice in a fiduciary capacity, is intended to be educational, and is not tailored to the investment needs of any specific individual. Fidelity and its representatives have a financial interest in any investment alternatives or transactions described in this document. Fidelity receives compensation from Fidelity funds and products, certain third-party funds and products, and certain investment services. The compensation that is received, either directly or indirectly, by Fidelity may vary based on such funds, products, and services, which can create a conflict of interest for Fidelity and its representatives. Fiduciaries are solely responsible for exercising independent judgment in evaluating any transaction(s) and are assumed to be capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies.

Information presented herein is for discussion and illustrative purposes only, and is not a recommendation or an offer or a solicitation to buy or sell any securities. Views expressed are as of the date indicated, based on the information available at that time, and may change based on market and other conditions. Unless otherwise noted, the opinions provided are those of the authors and not necessarily those of Fidelity Investments or its affiliates. Fidelity does not assume any duty to update any of the information.

You could lose money by investing in a money market fund. An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Before investing, always read a money market fund's prospectus for policies specific to that fund.

Fund definitions: Government MMFs typically hold most assets in cash, U.S. government securities, and fully collateralized repurchase agreements. Prime MMFs can invest assets in any eligible U.S. dollar-denominated money market instruments. Ultrashort bond funds can invest in a variety of fixed income securities with extremely short maturities, but may have higher risk than money market funds.

Investment decisions should be based on an individual's own goals, time horizon, and tolerance for risk. Nothing in this content should be considered to be legal or tax advice, and you are encouraged to consult your own lawyer, accountant, or other advisor before making any financial decision.

In general the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities.)

Fixed income securities carry inflation, credit, and default risks for both issuers and counterparties.

Past performance is no guarantee of future results.

Current and future portfolio holdings are subject to risk.

All indices are unmanaged. You cannot invest directly in an index.

The Chartered Financial Analyst (CFA) designation is offered by the CFA Institute. To obtain the CFA charter, candidates must pass three exams demonstrating their competence, integrity, and extensive knowledge in accounting, ethical and professional standards, economics, portfolio management, and security analysis, and must also have at least four years of qualifying work experience, among other requirements.

Fidelity Institutional Asset Management® (FIAM®) provides registered investment products via Fidelity Distributors Company LLC, and institutional asset management services through FIAM LLC or Fidelity Institutional Asset Management Trust Company. Personal and workplace investment products are provided by Fidelity Brokerage Services LLC, Member NYSE, SIPC. Fidelity Clearing & Custody Solutions® provides clearing, custody, or other brokerage services through National Financial Services LLC or Fidelity Brokerage Services LLC (Members NYSE, SIPC).

Before investing, consider the funds' investment objectives, risks, charges, and expenses. Contact Fidelity for a prospectus or, if available, a summary prospectus containing this information. Read it carefully.

924297.1.0