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USD Funding Conditions & FX Swap markets

Money Market Contact Group
Bineet Shah
Treasury Funding and Investments
Barclays Bank

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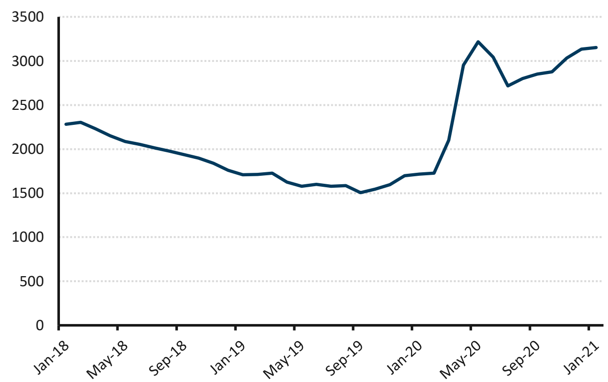
FED Intervention

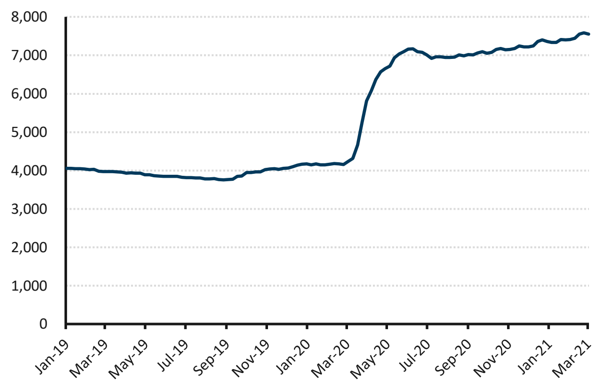
- The US Fed Reserve announced a variety of measures to inject liquidity to the funding markets through 2020 to tackle the Covid-19 driven crisis
- These include (but not limited to) Rate cuts, QE, RRP and USD swap facilities to central banks across the globe to provide access to USD liquidity and reduce funding stress (Chart 3)
- The above measures, along with other operations from the Fed, helped abate concerns on USD liquidity. As a result, USD excess reserves ($3.2 trn) and the size of the Fed's balance sheet ($7.5 trn) are now at historical highs (see Charts 1 & 2)
- In addition, the Fed has also provided strong forward guidance on interest rates remaining low for the foreseeable future until improvement in labour market and inflation targets are on track. This has led markets to price out any rate hikes until early 2023

Chart 1: Excess Reserves ($bn)



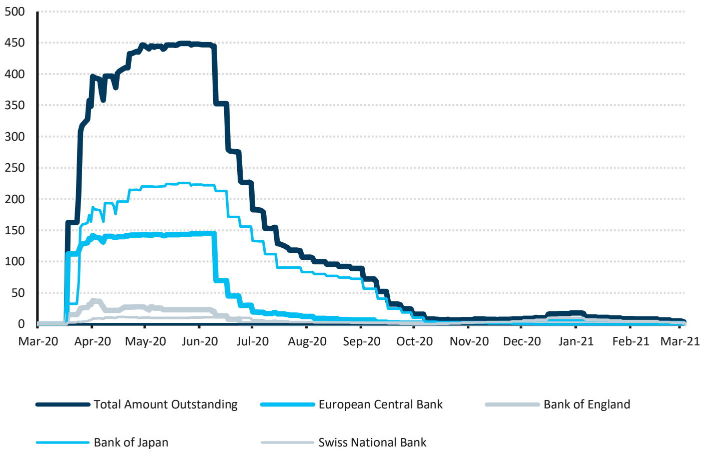
Source: Fed Reserve

Chart 2: Fed Balance Sheet ($bn)



Source: Fed Reserve

Chart 3: CB Swap Lines usage ($bn)



Source: Fed Reserve

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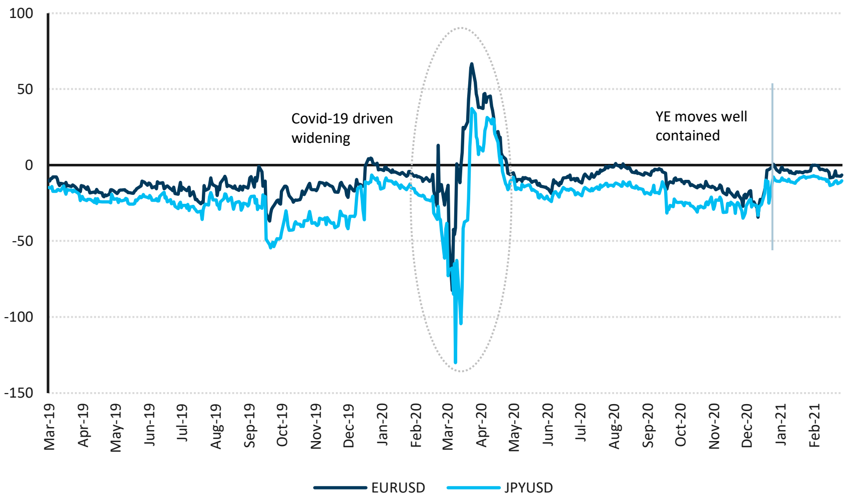
FX Basis

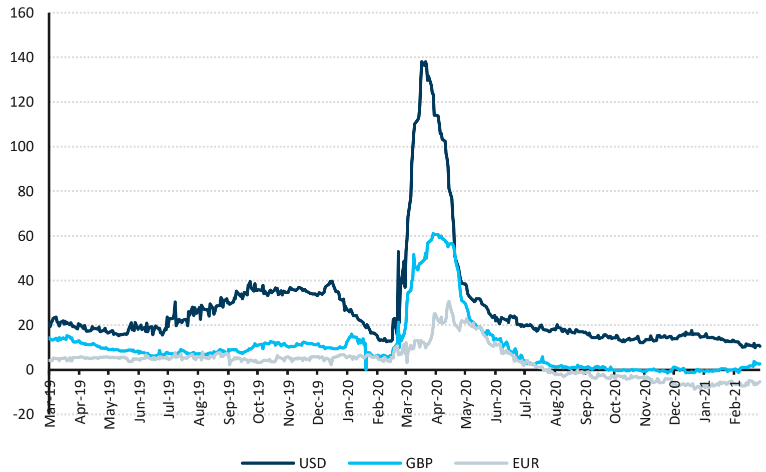
- As Covid-19 hit the markets in Mar/Apr-20, FX basis vs. USD moved significantly wider with the funding/liquidity stress also evident in the LIBOR-OIS basis moving materially wider
- However, following the Fed's intervention (as noted in prev slides), the liquidity stress started to abate with both FX basis and LIBOR-OIS basis tightening materially with the LIBOR-OIS basis now trading at levels tighter than pre-Covid-19
- FX Swap markets particularly benefited from the Fed Swap lines as this capped the cost of USD liquidity globally and helped contain large widening moves in the FX market through 2020

3m FX Swap Basis



Source: Bloomberg

FRA-OIS Basis

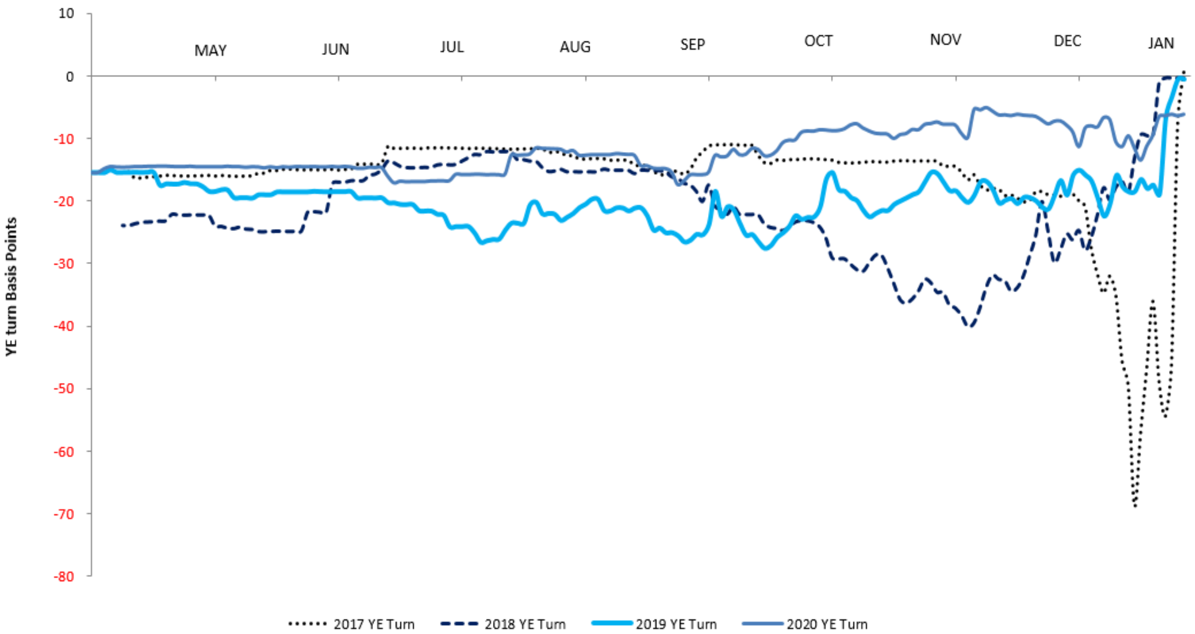


Source: Bloomberg

Different story over year end

- 2020 year end saw a slightly different compared to previous years
- As seen below for EURUSD, the YE turn effect was quite contained, which is again a function of ample USD liquidity available in the market. The moves were also similar for other CCYs such as JPY and CHF indicating lower funding stress vs. USD
- However, a notable aspect in 2020 was the sudden widening in the YE turn towards latter half of Dec-20 with the basis ending the year wider and not at par as it did in prior years as seen in graph below
- One of the main cited reasons for this move was around the timing of the YE flows - with excess USD liquidity, a lot of the flows for YE that would normally come in early Q4 did not arrive until Dec in anticipation of better execution levels on basis. And when the flows finally arrived closer to YE, dealers and banks struggled to take the other side given GSIB and Balance Sheet constraints resulting in basis ending up wider for 2020 YE

Chart 1: EURUSD Basis YE Turn (2017-20)



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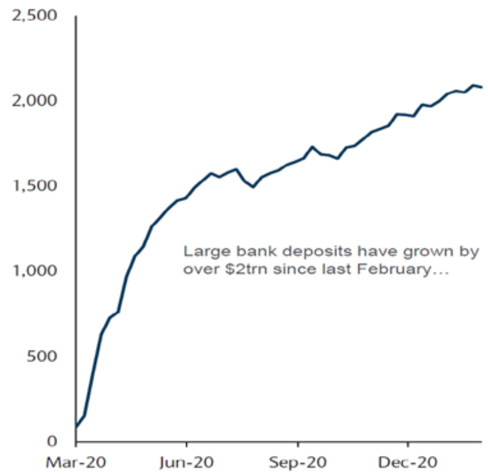
SLR Relief

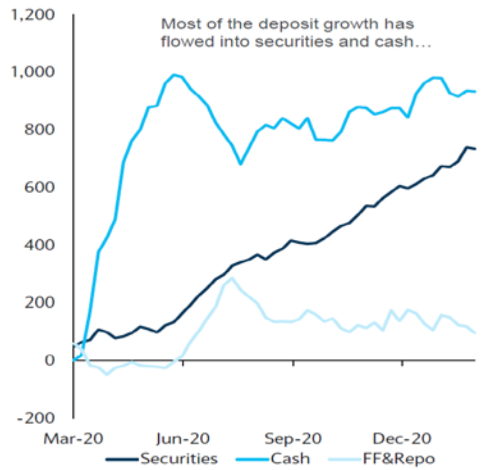
- One of the key announcements that the Fed delivered during the pandemic was around the temporary exclusion of USTs and deposits with the Fed from the calculation of SLR (Supplementary Leverage Ratio)
- Since the pandemic began, bank deposits have grown significantly (see Chart 1) . But given low demand for loans, banks end up having a large balance sheet (see Chart 3)
- With the above SLR relief, banks now have the ability to use these deposits to buy Securities (USTs/MBS) or deposit with the Fed without having any impact on capital(see Chart 2)
- The SLR relief is due to expire on 31st March 2021 but given the constraints around Bank Balance Sheet and Fed's QE program set to continue, the wider market expectation is for the relief to be extended
- In addition, the TGA (Treasury General Account) balance which is currently sitting at record high levels of $1.6trn is expected to be drawn down by $800bn by end of Mar-21 and a further $300bn by June-21. With this additional USD liquidity due to hit the markets, it is more than likely that the SLR exemption will be extended beyond Mar-21

Chart 1: Bank Deposits ($bn)



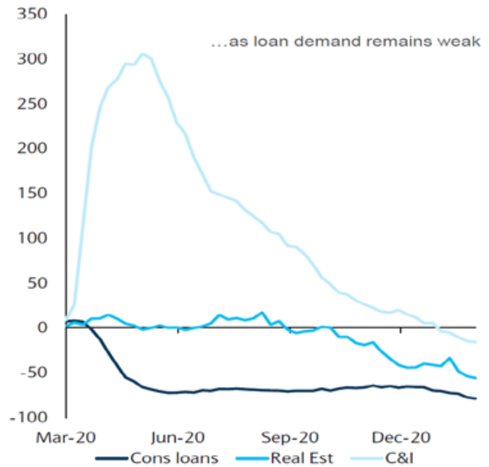
Note: Excluding time deposits. Cumulative growth since February 2020. Source: Federal Reserve, Barclays Research

Chart 2: Bank Securities ($bn)



Note: Cumulative growth since February 2020. Source: Federal Reserve, Barclays Research

Chart 3: Bank Loans ($bn)



Note: Cumulative growth since February 2020. Source: Federal Reserve, Barclays Research

Issuance Overview

- The ample USD liquidity has resulted in term XCCY basis also getting tighter
- Table 1 below shows the split of issuers across the globe and the 'Cheapest To Deliver CCY' for issuance. Given the ample USD liquidity and lower term rates, it is becoming increasingly cheaper for non-USD Issuers to issue in USD and swap this back to natural CCY of their balance sheet where required
- Chart 1 highlights this for a sample of Financials where it is cheaper to issue in USD vs. EUR including XCCY basis across most tenors
- This is further evident from Table 2 where USD issuance by European Financials/Agencies in Q1 in 2021 is much higher compared to Q1 issuances in previous years.

Chart 1: Sample Financials Issuance Levels - USD vs. EUR (with XCCY)

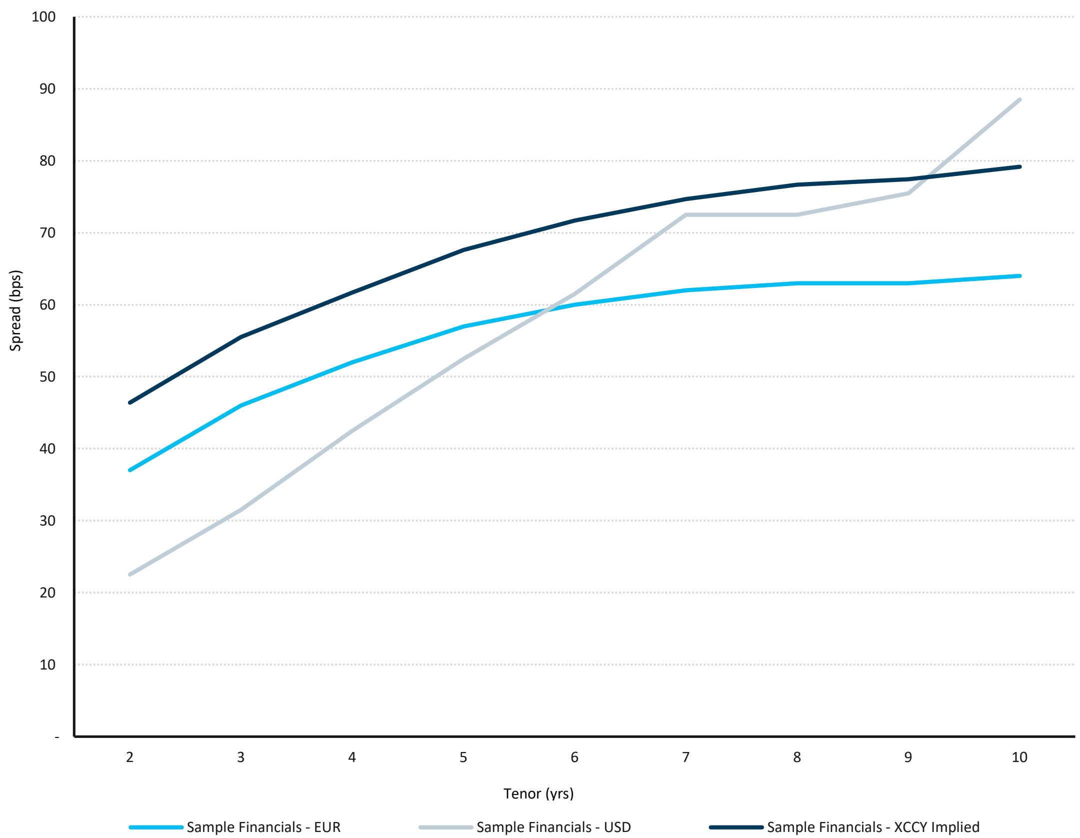


Table 1: CTD CCY Issuance Grid (Region/Tenor)

Financials -> by region

	USD				EUR				GBP				AUD	JPY				CAD				CTD CCY Issuance			Balance Sheet CCY
COUNTRY / REGION	2Y	5Y	10Y	15Y	2Y	5Y	10Y	15Y	2Y	5Y	10Y	15Y	2Y5Y10Y20Y	2Y	5Y	10Y	15Y	2Y	5Y	10Y	15Y	2Y	5Y	10Y	
Europe	0.42	0.84	1.71	1.67	0.69	0.90	1.03		0.74	0.80	1.22			0.92	1.14							USD	GBP	EUR	EUR
Canada	0.27	0.55			0.66	0.70												0.42	0.55			USD	USD		CAD
UK	0.26	0.87	1.29	1.44	0.71	0.79			0.43	1.12	1.33			0.94	1.58			0.44				USD	EUR	USD	GBP
AUSTRALIA	0.15	0.44	1.43	1.47	0.51	0.62	0.51							0.86								USD	USD	EUR	AUD
US	0.40	0.92	0.79	1.10	0.81	0.89	0.88		0.63	0.79	1.09							0.48	0.76			USD	CAD	USD	USD
JAPAN	0.28	0.63	0.89	1.15	0.78	0.76	0.91															USD	USD	USD	JPY

Table 2: Historical Q1 Issuances by European Issuers (CCY bn)

Issuer	B/S CCY	Issuance CCY	2016	2017	2018	2019	2020	2021
SSAs	EUR	USD	33.9	34.6	42.0	28.9	14.6	35.4
		EUR	39.1	44.6	28.2	41.6	43.5	29.8
Financials	EUR	USD	11.9	23.2	21.1	18.2	11.3	18.0
		EUR	79.1	66.3	70.6	90.4	71.8	40.8

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