Federated Hermes

Fed lends a hand to businesses

The short end of the commercial paper market is the latest to get Fed support.

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The Federal Reserve today addressed one of the key aspects of the financial markets that has come under strain due to the impact of the coronavirus. It announced it will buy commercial paper directly from the marketplace to help support broad funding needs. The program—called the Commercial Paper Funding Facility (CPFF)—was created for and last used in the 2008-2009 time period to help reduce liquidity stress for high-quality, short-term issuers. The markets had hoped to see this last week, but it is good to have it in place. It should facilitate the financing needs of corporations, which should lead to a reduction of the larger spreads and higher rates for these issuers.

Liquidity is not a problem along the commercial paper curve. Instead, it is a case of trader bid and ask offers not finding common ground. Investors want to keep maturities short because of uncertainty about their clients' liquidity needs; issuers would rather fund themselves further out the curve to reduce their rollover risk in the current environment. The CPFF is designed to help the two sides meet in between.

While the Fed doesn't lend directly to businesses, the facility provides a way for high-quality short-term commercial paper issuers to get term funding, which they require for their strategic and operational needs. With the financing needs of the commercial paper issuers met by the CPFF, bank balance sheets should be freed up to provide active markets for secondary commercial paper trades to help facilitate two-way market flow and reduce bid/ask spreads.

TAGS

CORONAVIRUS | LIQUIDITY | MONETARY POLICY | MARKETS/ECONOMY

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Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

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