## 2020-4-30 Brazil fiscal policy

1. At the beginning of the year, we're expecting 1.5% of GDP primary deficit. Last year, 2019, was the fourth year in the last 5 year we're able to cut the debt to GDP. The gross debt to GDP was 51% in 2013 and reached almost 78% before you were able to cut. But not this year. Because of the coronavirus you would probably have it 80% of GDP.

2. ow instead of a 1.5%, primary deficit is nearly 8% GDP. The debt to GDP will go up from here to something like 85%-90%. We need to treat differential of the year. The congress is making it easier to make temp expenditure only related to the coronavirus. There's no flexibility to create permanent expenditure. The public expenditure needs to be restricted to this full year. It will depend on the actual revenue.

Source: issuance + privatization. 1.2 trillion(300bn can't be touched) of account in the central bank. Cash cushion in the cental bank. Always need some cash cushion for repayment. Probably need to raise the money mainly from the Market.

3. 85% to 90% of GDP

4. Only make temporary expenditures. No flexibility to increase permanent expenditure.

5. Depend on actual revenue

6. To decide at which stage to go back to the market to raise money

7. Have very high cash cushion, selling short term bond in a more progressive way

8. Interest in brazil is very low. Short term interest rate linked to 50% of debt

9. No problem to finance the debt

10. Nobody expect high inflation in Brazil

11. No delay the concession.

12. Negotiation with the senate:

13. GDP growth -3% to -5%. Difficult to say right now. Not complete lockdown? People not respecting lockdown?

14. Bluecrest: when to extend?

## 2020-4-7 Recap on Simon, Fed funding stress

-Due to LCR requirement, funding shorter than 30 days is not useful for banks.

- Banks had interest in borrowing in the unsecured market 3m or longer.

- CP: commercial paper, short term unsecured.

-CD: Certiicate of deposit.

- As cash outflows reduced weekly liquidity, prime MMF were forced to try to build liquidity by selling longer term CP/CDs and only buying short CP/CDs.

- Mismatch between banks wanting to borrow 3m, and MMFs selling long.

- overnight financial AA CP traded at 16 bps, 3m 206 bps.

- Dollar swap lines: Fed gives USD to another central bank at OIS+25 bps and that central bank distributes them and take the credit risk.

- Money market liquidity facility: pulls longer CP,CDs from the money fund. improving their weekly liquidity

- Commercial bank funding facility:

-CCAR: stress test. 35% recession is ok to survive.

- Corporate debt market. High prob of default. 2%.

- small business. 50%. Recovery 20%. Spend a lot of capital

- US treasury.

- Very difficult to payback.

- Disinflationary pressure to fight against.

- repo facility: new. 2014: safe place to store cash, earn a good rate, 300bn, MOF japan has large chunk of that. Make money on cash.

- FIMA repo: 3trn NY fed, temp liquidify the US treasury. Cheap funding. Dealer might not want to face you in big size. - you don't want to blow 6trn dollar treasuries over a few weeks.

- Leverage ratio: OCC(), FDIC(Fed deposit corporation). Soverign debt included in the leverage ratio

- Germany: large balance sheet but in risk weighted asset it's tiny. (14:49)

- European would very concern about a backstop which include the sovereign debt.

- The compromise was to include central bank deposit in your own currency and your own sovereign. Never makes sense to me, but there's politics there. You do not have to hold capital against the liability of the Fed. US treasury is ok. You don't have to hold capital against that. It will be crazy to have capital constraints because there will be trillions of dollars of treasury to hold in the next few months (when talking about the primary dealers).

Flora: the leverage releasing measures have relatively small impact on the bank. Not worth doing it.

- FX swap and the new repo facility. There're some signs that the dollar funding pressure is alleviating. Is there a risk that the pressure could come back?

- Indonesia says that they're taking up 60bn from FIMA(=foreign institutional monetary authorities) repo. There's a debate about how much collateral you have to put with the central bank. How much haircut, volatility of exchange rate. There has been funding issue in 2015-16, 2019. Libor has two pressure: funding pressure and credit risk. 2008 was more a serious credit risk issue. Now US banks have a really good buffers against a severe recession.

- In Europe the banks never got the capital ratios up to the same level. No backstop of the bank debt.

- Where is the end game for these dollar facilities? FX swap lines have been there for decades. But what about the repo facilities. Do you think it is a permanent feature? Many central banks offer the repo services to their fellow central banks. The argument against it is that people may not be prudent when they make choices. Because they know they could always liquidify their assests. Let's go back to 2015-16. Large country was trying to fight exchange rate pressure.

- Regarding the FX swaps. Imagine you have a harmonious world should be. But unlikely that China and the US will forget.

- practical question: if a central bank has 30bn treasury, how much can he get. Answer: google "discount window haircut". The risk is obviously adverse price move. If the price of the Treasury drop a lot and the counterparty fails to deliver the cash back. Distributed 100mn of cash to criminals. There're operational risk with other central banks.

- What's left in the toolbox.

- Answer: relief to the SLR. Leverage ratio. In Europe and UK, there is strong guidance towards stop capital distribution.

- Public don't know how big the recession gonna be. The overall strategy has the risk of unknown of the depth. Adjusting to it is really critical. Whether or not you should let bank eat through their capital buffer? In one state of the world it can be the right thing. In another world you go say please eat through your buffer and we can give you if it goes wrong. Small business loan...

- 3m dollar libor is still quite elevated. Libor is still the best signals.

- Libor is more disciplline that they were in 2008 on what they report. There's a few points out there that Libor is lagging CP rates were. Let's say it's a funding issue not a credit issue. Then it gets into the very complexed structures of the Libor panel. Who has access to the fed facitilities and who doesn't. The German bank I mentioned, that was downgraded from A1 to B2 long time ago. If you have a bank that is much lower rated... Libor is pricing in all the other things... Libor is an issue of transmission of the monetary policy. The fed should at some point look at that and say we have to fix it. You have to do that under the existing risk taking that the fed has. Commercial paper funding facility is basically for the top tier, with the option that you're downgraded in the last few months.

- How do you see the regulatory changing overtime to address this?

- The idea of LCR is that when the time of stress you can eat into that.

- If the fed would ever buy the high yield?

- If it is logical to buy the cruseline, you find a way to buy them. The more pressure you take off the agency MBS and quality assets, you let private money to buy those as long as there's backstop.

- 50:09 Dollar is so far orthodox, no other currencies can replace it.

## 2020-4-29 Simon Potter

Call Speakers for The U.S. Economic Outlook: What is Next for the Fed? With Simon Potter  
Speaker: Simon Potter – Former Head of the NY Markets Group at the Federal Reserve and Non-resident senior fellow at the Peterson Institute for International Economics  
Moderator: Andrew John Morton – Global Co-Head of Markets and Securities Services, Citi  
Highlights  
General Overview of Fed Programs thus far:  
· The Fed has rolled out nearly every program from 2008 and much more. A big innovation has been the programs for lending to corporates which would have been unimaginable in 2008.  
· The reason for these measures is that this is a very different type of shock than the GFC.  
· When strain hit capital markets in late February and early March, the Fed took many steps in the markets. The majority of the action was in UST markets. They set records in terms of treasuries and agency MBS purchased.  
· **March 23 was a very important day in that the Fed used its full set of powers to announce lending to a wide range of counterparties within the US.**· While projecting this crisis is very difficult it is clear we will have a depression-like decrease in output and increase in unemployment. However, the recovery will be better than the typical depression scenario.  
· While moral hazard is a concern, it is a much smaller concern when the crisis results from an exogenous shock as it did here.  
· Does not see this as a time to let moral hazard bog down stimulus. That should be a concern for after the crisis.  
QE and Balance Sheet:  
· While there are limits on the amount of buying the Fed can do, it can be much more comfortable in operating with a larger balance sheet than in 2008.  
· One concern is that if rates are raised, the Fed could see potentially negative income on its balance sheet holdings.  
· Imagines that the Main Street lending program will realize some losses on individual loans. The question is whether the income from the other loans compensates for this.  
· In the past, the goal of QE programs was to get long and medium term interest rates down. That was not really the driving force of this QE.  
· What does the Fed want to see in the yield curve? Low real rates, inflation compensation around its goal that is being transmitted into financial conditions.  
· It may be difficult for private markets to absorb the massive amount of treasury issuance in the pipeline.  
· Next week will be telling as the treasury will announce its more long term plans on how to finance its expenditure.  
Potential for Negative Rates:  
· Right now, options markets are pricing a non-negligible chance of rates going below 0.  
· The Fed has been clear this is not something they are considering at the moment.  
· There is an argument that the Fed may want the market to price some chance of negative rates as it brings rates lower across the curve.  
· Sees 0 evidence that mildly negative rates are helpful in Europe and Japan.  
Actions of the ECB:  
· It is clear that different central banks recognized the severity of the crisis at different points.  
· The ECB was one of the latter to realize it. **There was also the mistake of saying its job is not to compress spreads.**  
· The ECB’s problem is much more difficult than the Fed’s. There are much more restrictions on its purchases.**( The so-called issue limits -- which constrained ECB bond buying to a third of each government’s debt -- “should not apply” to the emergency plan, the central bank said. )**Upcoming Fed Meeting:  
· Pro of raising IOER by 5 bps is that you eliminate the market dysfunction that accompanies negative rates trading.  
· The con is that you do not usually raise your own funding costs during a depression/recession.  
· There has not been much evidence of widespread negative rate trading yet.  
· Sees 0 chance that Fed Funds will trade less than 0 with IOER where it is.  
Inflation Prospects:  
· There is not actually a large amount of inflationary fiscal stimulus right now. It is mostly transfer payments to help households bridge the gap until reopening.  
· This will in large part depend on how quickly incomes recover. Not very optimistic on this.  
· Overall though, inflation will be much more driven by things like oil in the near term.

## 2020-3-2 GS on Fed cut

GS: 50bps in March

50bps in 2q

2% growth gdp global

1.       Quarantine, 15-20% og global economy. China pmi 35. 2.5% gdp yoy

2.       Spill over through.

3.       Reduce good export to china

4.       Damage to supply chain.

5.       Hit to domestic spending affects countries outbreak, korea, Italy.

a.       Air travel

b.      Entertainment

c.       Large gathering

6.       1.3% in US gdp, 1% taken away.

7.       Downside on consumer spending.

a.       2-4% hit on consumer spending

b.      Not only Q1, but also Q2, recession

c.       Upside scenario unlikely.

8.       Ultimately will be a V shape recovery

9.       CB calls:

a.       Fed move aggressively. Money might not do much?

                                                               i.      Public health and fiscal more important, but CB not control

                                                             ii.      They’ll be using their ability to do something

                                                            iii.      Inflation is not a big concern

b.      Doing nothing is tightening when market is pricing easing

c.       Last year 75bps, economy not yet bounced higher

10.   Start with 50bps cut this week

11.   CAN, Japan looking to cut

12.   Possibility of coordinated cut, next week, joint statement

13.   China:

a.       Latest data:

                                                               i.      Far below normal

                                                             ii.      2/3 firms restart

1.       Migrate workers not back

2.       Power genr, transportation 30% below normal

                                                            iii.      Property trans 1/3 recovered

                                                           iv.      Steel demand ½

b.      Government stimulus:

                                                               i.      Very weak q1(-6% annual), weak q2

                                                             ii.      Worse than 08 crisis

                                                            iii.      Significant easing, strong desire to addict to social target

                                                           iv.      Shift from virus control to economic recovery

                                                             v.      Fiscal:

1.       3% increase in augmented fiscal deficit

a.       Off-budget

2.       200bps in RRR, 50bps in LRF rates, money easing

3.       Credit growth

4.       Don’t think there’s broad based housing easing

5.       No large depreciation in CNY

14.   Risky assets:

a.       Still in the process of pricing the full range of possible outcomes

b.      Long JPY/USD

                                                               i.      Aggressive fed easing

c.       Front end long: UK, CAN

d.      Equity market:

                                                               i.      fundamental

                                                             ii.      valuation

                                                            iii.      V shape:

1.       Earning 2020, no growth.

2.       2021: arise around 6%

3.       Trough: 2900.

4.       Earning yields 6%

5.       Treasury yield 1%

6.       Gap: 500 bps

7.       End of the year: 3400, p/e 19.4

8.       Downside: 2450.

                                                           iv.      Very well orders:

1.       Sell-off in beta-implied-would-be sector

2.       Overweight:

a.       Tech: software

b.      Real estate

c.       Health care sector

3.       Overweight:

a.       Domestic oriented companies

4.       Dividend: 3.9%

15.   Fed takes back 100bps? Too early to envision that. Depend on a lot on inflation number.

16.   USA: 1.3% gdp, 0.9% q1, 0 q2(potential hit to consumer behaviour, weak in entertainment, public transportation, gambling).

17.   PBOC will follow lock step? Won’t follow one-on-one steps. RMB: inflation high. Leverage. RMB outperf the others, maybe catch up a little bit. This is not a China issue anymore. Fed cut: dollar weakness.

18.   How would they use the cash: 90% of US companies buy back desk 2-3 times than usual. Many maxing out. 8 bn dollars a day.

19.   Fiscal policy: US and Europe. Now small, but likely to growth is community spread. Free up room to stabilize the economy. Money policy more quickly.

20.   US election: implication: too early to tell. More of how admin deals with the crisis.

21.   Europe: ECB: 10bps cut expected. March 12. Likely to join coordinated cut. QE will do more.

a.       Eur: negative shock for the EU area, currency negative

b.      EUR-MXN was popular trade in FX market

c.       EUR rallying because risk reduction in the portfolio, carry trade extra.

d.      Squeeze higher in the short term.

e.      Hard to see the EUR rally a lot, will be pricin’ into EUR itself

22.   Asset purchasing: ECB ramping up. Use convention first elsewhere.

23.   Global credit event: depend on global recession in major economies.