

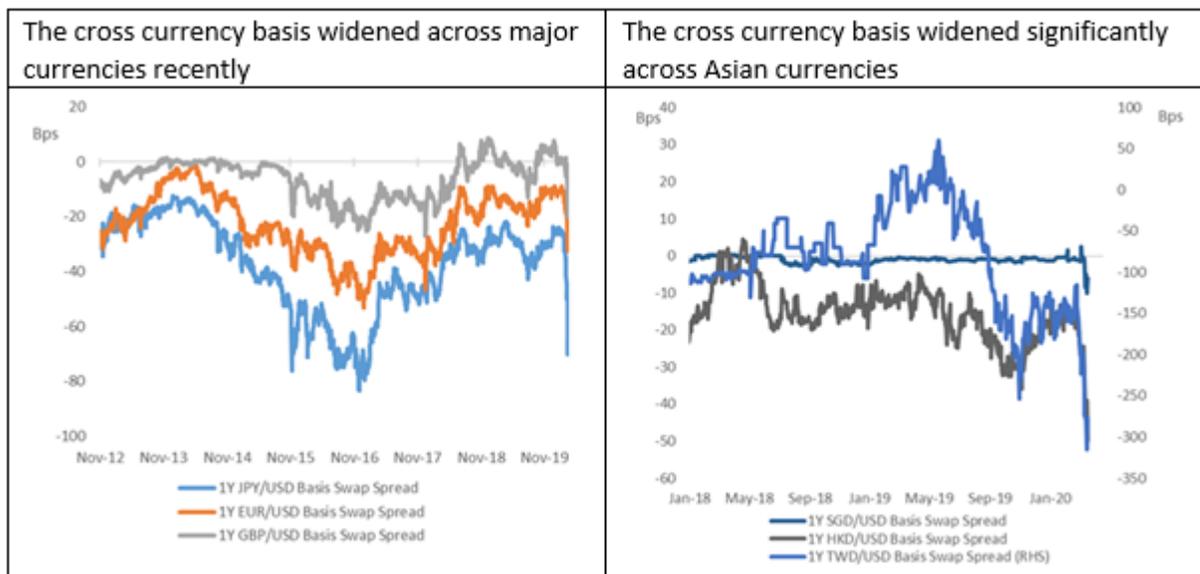
Covid-19: Stress in the offshore US dollar funding market

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As a result of the increased risk aversion due to the Covid-19 shock, the offshore US dollar funding market is showing signs of stress.

This is reflected in the increase in cost of borrowing US dollars against local currency in the FX swap and cross currency markets - as measured by a more negative (wider) cross currency basis.

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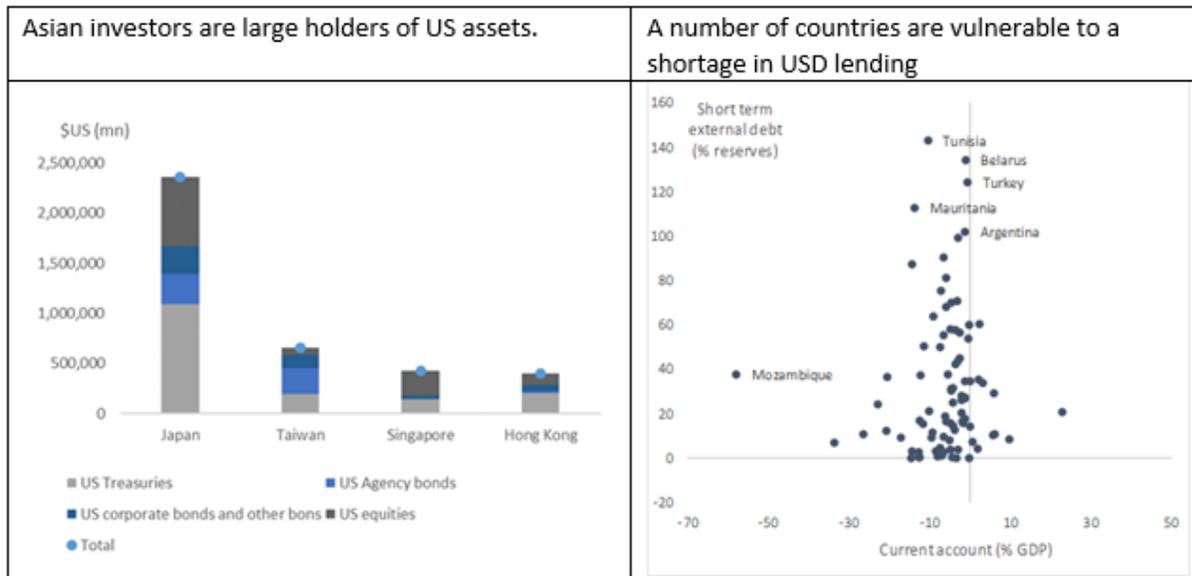


This is important. First, USD funding backs FX hedged investment into USD assets, thus foreign financial institutions facing shortage of USD may become net sellers of USD assets, exacerbating moves in financial markets. Second, USD funding backs USD lending internationally, so the widening in the cross currency basis could indicate looming financial stress in economies that receive cross-border credit flows, e.g. Turkey, South Africa.

¹ **Source for chart 1:** Citibank, accessed March 19, 2020; **Source for chart 2:** Citibank, accessed March 19, 2020

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2



The Fed has already activated arrangements to ease pressures for offshore US dollar liquidity in the form of central bank swap lines with the Bank of China (BoC), Bank of England (BoE), Bank of Japan (BoJ), European Central Bank (ECB) and Swiss National Bank (SNB). The Fed also introduced new swap lines with 9 central banks around the world (i.e. central banks of Australia, Brazil, Denmark, Korea, Mexico, Norway, New Zealand, Singapore, and Sweden). However it is still to be seen if this will be enough.

First, continued stress in the cross currency basis of economies with existing swap lines with the Fed suggests that current measures may need to be expanded, for example by conducting daily operations rather than weekly. Second, many central banks of economies with significant USD funding needs, most notably in Asia (e.g. Taiwan, China), are still not covered by swap lines.

“This is an important subject, arguably the most important factor at play in the markets at the moment,” says BNY Mellon Investment Management chief economist Shamik Dhar. “Look past the sell-offs in equity and bond markets, and behind it all is a huge spike in the demand for dollar cash.”

² **Source for chart 3:** US Department of the Treasury, accessed March 19; **Source for chart 4:** IMF and World Bank, accessed March 19



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