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Central Bank CP Backstops Vital But May Not Fully Restore Liquidity

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Fitch Ratings-Chicago-15 April 2020: Emergency short-term market support measures by central banks around the world to unfreeze CP markets may not fully restore market liquidity, says Fitch Ratings. Central banks introduced the CP programs after coronavirus-driven risk aversion caused spreads to widen and made it difficult for borrowers to issue CP. While these measures stabilized parts of the financial market during a period of extreme volatility and uncertainty, rollover risk will not be eliminated for low-investment-grade corporates in the US and financial institutions in Europe due to participation restrictions.

Parameters of the US Federal Reserve's (the Fed) Commercial Paper Funding Facility (CPFF), the Bank of England's (BOE) Covid Corporate Financing Facility (CCFF) and the European Central Bank's (ECB) Pandemic Emergency Purchase Program (PEPP) vary, leading to uneven levels of support and continued market uncertainty. Measures will provide backstop facilities for CP issuers but issuer credit quality eligibility requirements and restrictions on securities covered limit program breadth. If liquidity is not restored, terming out CP with higher-cost debt will reduce issuers' interest coverage. However, this alone will not necessarily have negative rating implications.

There is a lack of similar broad policy measures in Europe to support money market funds, as in the US, given the BOE's CCFF and ECB's PEPP only apply to non-financial CP. Fitch revised its sector outlooks for US and European prime money market funds to Negative from Stable over the last month, despite central bank policy measures. The actions were due to redemptions, reduced liquidity in short-term markets and an expectation of increasing credit pressure on underlying portfolio holdings.

The Fed's CPFF, announced March 17, launched on April 14. In addition to CPFF, the Fed also announced a Money Market Mutual Fund Liquidity Facility to indirectly support money market fund liquidity. CPFF purchases US dollar- denominated three-month unsecured and asset-backed CP of US issuers, including municipalities and subsidiaries of foreign parents, rated at least 'F1' or equivalent.

Unlike other central bank facilities, CPFF only makes one-time purchases of a limited amount of CP from issuers that met credit quality eligibility requirements on March 17 but were later downgraded to no lower than 'F2' or equivalent. The Fed created separate facilities to support high-yield issuers in the bond market.

US CP rates have declined from stress levels for Tier 1 'AA' non-financial, 'AA' financial and 'AA' asset-backed CP, per Fed data. However, 'F2' or equivalent rates for Tier 2 issuers remain elevated versus pre-virus levels, potentially reflecting the limited ability of lower-rated investment-grade issuers to participate in CPFF and increased credit risks facing such entities, relative to higher-rated entities, in the current environment. Total CP outstanding in the US is down roughly 5% since mid-March to USD1.1 trillion as of April 8.

The BOE's CCFF, launched March 23, will operate for at least one year. The facility purchases sterling-denominated unsecured CP with maturities of one week to 12 months issued by UK incorporated companies rated at least 'F3' or equivalent, where available, prior to March 1, 2020. Unlike the Fed's facility, CCFF does not purchase asset-backed CP and excludes issuers that are financial institutions and municipalities. Per BOE data, monthly gross issues of sterling-denominated CP by public non-financial companies declined 23% in February. March data is not yet available.

The ECB's PEPP, launched March 26, terminates at YE 2020. The PEPP purchases Euro-denominated CP with maturities of 28 days to 364 days issued by European-area corporates with a minimum short-term rating of 'F2' or equivalent, such as the BOE's CCFF, issuers that are financial institutions and municipalities cannot participate. The ECB also expanded its Corporate Sector Purchase Program to include eligible CP to provide CP market support. Per ECB data, total issuance from non-financial corporates rated 'F1' and 'F2' has trended down since the end of February by over 5% to EUR30.3 billion on April 3.

Global Commercial Paper Outstanding

Source: Federal Reserve Economic Data, Bank of England Database (CPMB55M), and European Central Bank Eurosystem.

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Source: Fitch Ratings and Central Bank Press Releases and FAQ website documentation.

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