COVID 19 and the financial system: How and why were financial markets disrupted?

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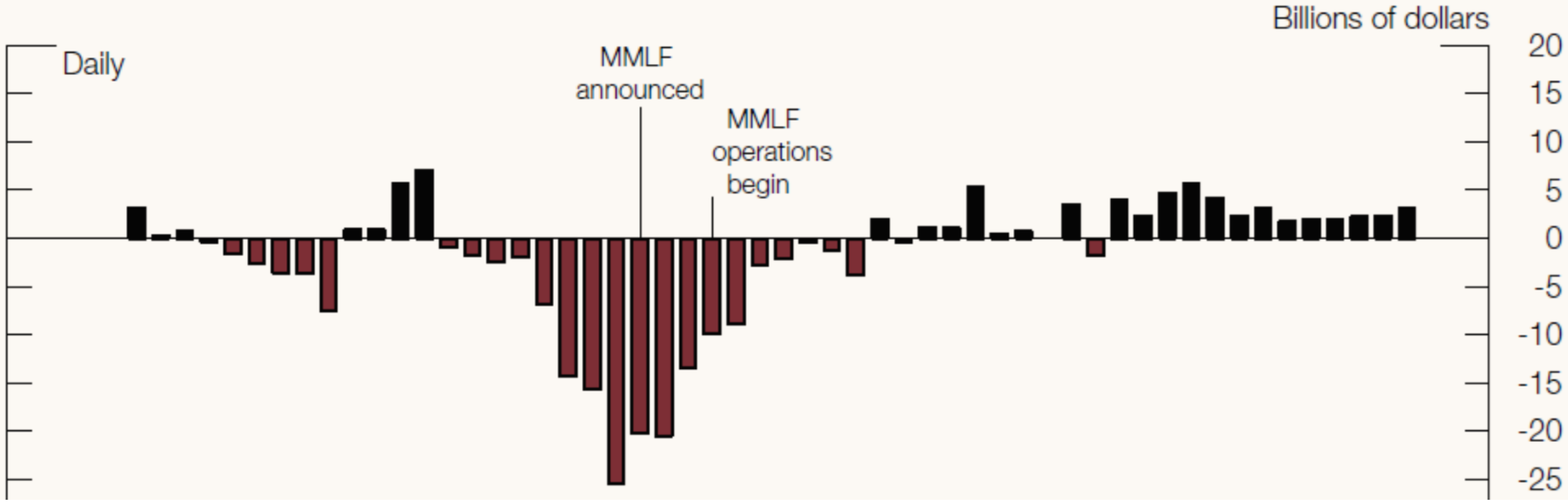
Institutional Prime MMFs

Figure B shows that during the COVID-19 outbreak, institutional prime MMFs experienced heavy redemptions. The announcement and implementation of the MMLF helped stem such outflows.

Figure B. Prime Money Market Mutual Fund Net Flows

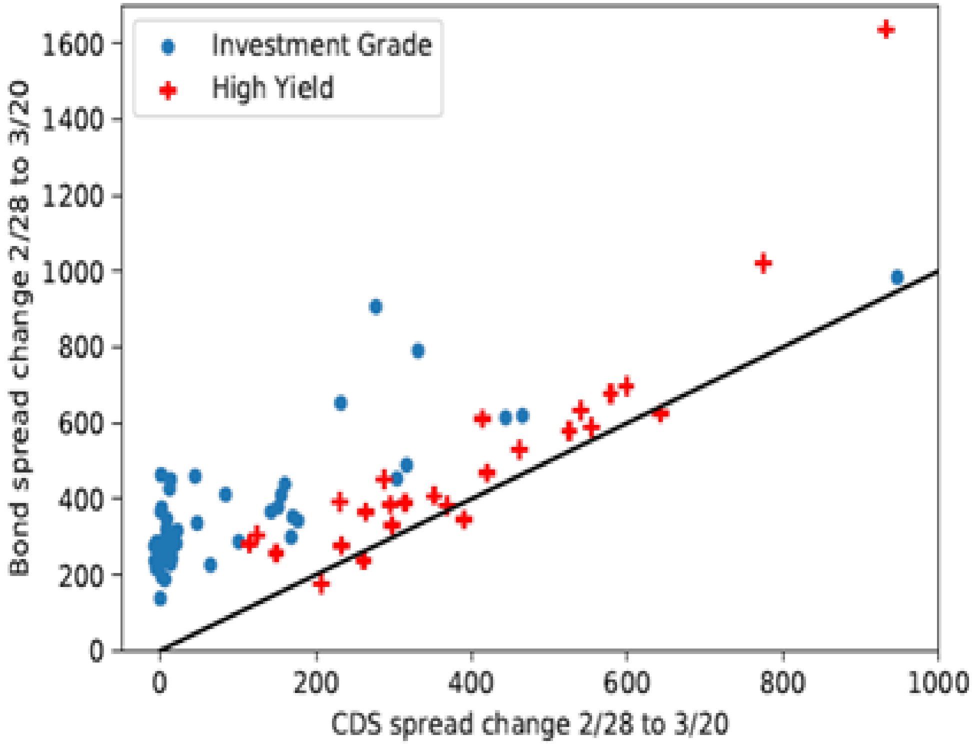


Source: Federal Reserve Financial Stability Report, May 2020

Investment-grade corporate bonds

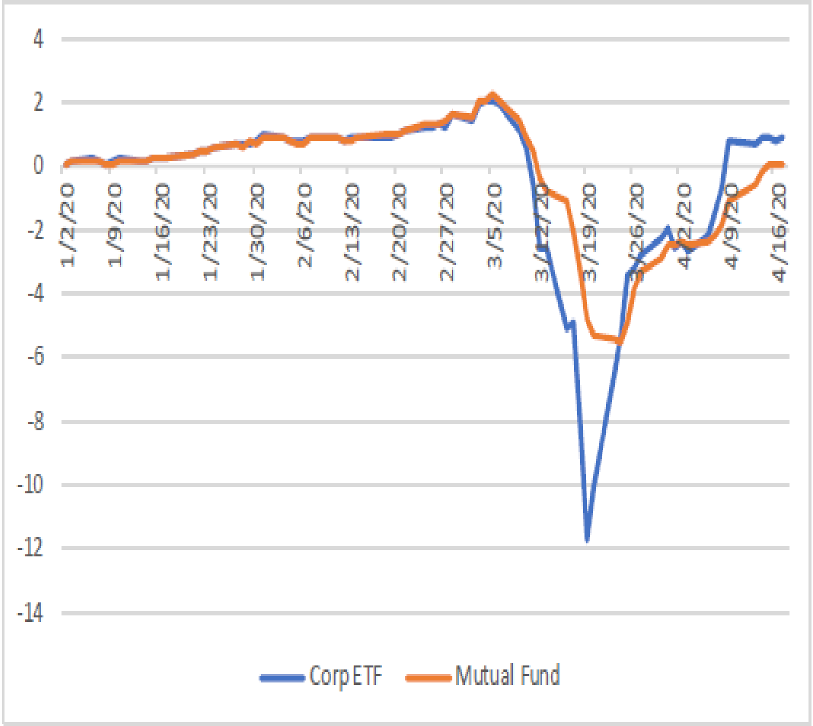
Haddid, Moreira, Muir (2020)

Figure 9: CDS Bond Basis at the Bond Level.



Note: Bonds in both ETFs and on-the-run CDS indexes, 4-6 years.

Panel A: Vanguard Mutual Fund vs ETF Short Term Corporate Index



Note: ETF and Fund track the Bloomberg Barclays US corporate bond index 1-5 years. Figure 18 in paper

Federal Reserve emergency liquidity facilities

- Money market mutual fund liquidity facility – MMLF
  - Fed lends to dealers based on collateral they purchase from MMFs, such as commercial paper and short-term municipal securities
  - $10 billion credit protection from the Treasury
  - Also created Commercial Paper Funding Facility (CPFF)
- Corporate Credit Facilities - PMCCF/SMCCF
  - Designed to work together, to improve provision of credit to companies hurt by the virus
  - High secondary market yields would increase borrowing costs to companies because seasoned bonds compete with newly-issued bonds
  - Buy shares in exchanged-traded ETFs – quick and broad support to the market
    - ETFs exempt from CARES, conflict of interest
  - Also PMCCF/SMCCF extended to companies that were downgraded recently. Helps to prevent a big gap from opening up between IG and HY.
  - $75 billion equity from Treasury