FedFin Daily Briefing

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Treasury Turns to New Currency "Manipulators"

Moving on from its almost exclusive focus on Chinese currency practices, the Trump Treasury Department's final currency-manipulation report today instead targets Switzerland and Vietnam as currency manipulators. This designation carries no explicit penalties, now more true than ever since the Biden Administration is considerably less likely than the current one to adopt the Commerce Department's countervailing-duty remedy (see FSM Report **FOREX16**). However, it still casts a cloud over economic, trade, and financial relations with these nations, complicating any near-term transactions such as mergers or acquisitions likely to encounter both political and administrative protests due to this designation even though Treasury acknowledged that Switzerland's practices have a rationale broader than trade subsidy. The report also adds India, Taiwan, and Thailand to the list of nations monitored for currency manipulation, a list that continues also to include China, Japan, Germany, Korea, Italy, Singapore, and Malaysia.

GAO: Leveraged Loans Demonstrate Need for Tough FSOC Designation Authority

The GAO today released a self-initiated study of leveraged lending, using both public and confidential data to conclude that – while still worrisome – leveraged lending does not pose immediate systemic risk. This is not because leveraged lending has suddenly become prudent, but because no major financial institution is at such risk due to leveraged-loan exposures that its weakness could imperil financial stability. Large banks and insurance companies weather dash-for-cash selling pressures well and, while mutual funds sold exposures, downward asset prices also did not prove systemic. However, GAO warns that this institution-specific assessment does not ensure that leveraged loans themselves pose no risk. It thus recommends that FSOC undertake monitoring and table-top projects to ensure better understanding of this sector's systemic risk. GAO also reiterates prior calls for Congress to give FSOC expanded authority to ensure activity-and-practice designation once an overall sector in which firm-specific designations are not viable is found to pose systemic risk. Janet Yellen as Treasury Secretary is sure to endorse this recommendation; whether Congress will advance it is very much to be seen.

FSB Data on NBFIs Backstop Holistic Work Plan

Today's FSB's annual global NBFI monitoring report includes two case studies updating the usual year-end data and assessing COVID's impacts. Relying in part on findings from its holistic review (see Client Report **NBFI**), the FSB concludes that the NBFI sector decreased by almost four percent in the first quarter of 2020 and its share of global financial assets fell from 57 to 54 percent. The asset decrease was driven primarily by equity, fixed-income, and mixed funds – down 20 percent, four percent, and ten percent – while MMF assets increased by 16 percent. Fixed income funds initially increased their exposure to short-term and more liquid assets and decreased credit intermediation but reverted to previous levels in the second quarter. Entities engaged in market intermediation dependent on short-term funding and securitization-based credit intermediation also increased assets.

The MMF-specific case study finds that there were significant outflows from dollar-denominated non-government MMFs in the EU and U.S., straining some of these funds. EU low-volatility net asset value funds denominated in U.S. dollars faced the largest liquidity strains; in the U.S., outflows were concentrated in prime institutional MMFs. Interventions by central banks were key to easing liquidity pressures in both the funds and underlying markets and all MMFs were then able to meet redemptions.

The full report is largely based on end-2019 data. The widest measure – now referred to as the "NBFI sector" – grew 8.9 percent in 2019, again outpacing the growth of the banking sector. The NBFI sector accounted for approximately half of all global financial assets and 56 percent of average assets in advanced economies. NBFI sector growth was driven primarily by increases in investment funds, pension funds, and insurance corporations mainly due to valuation increases in equity-price recovery after 2018.

Powell: Fed Averse to Permanent Treasury-Stabilization Role, Green Monetary Policy

At his press conference today, FRB Chairman Powell refused to commit to any permanent role for the Fed in the Treasury market, saying that liquidity and stability are best provided by the private sector. Recent reports from both the Fed (see Client Report **SYSTEMIC89**) and FSOC highlighted the need for Treasury-market structural reform, with the Fed chair confirming that considerable work is underway to determine possible reforms, perhaps including the central clearing he espoused as a Fed governor after the 2008 crisis. Mr. Powell also said that no additional 13(3) facilities are under consideration at present, reminding the questioner that the Fed does not need Treasury funding for such backstops, but that its approval is required under the Dodd-Frank Act. Mr. Powell's grim assessment today of coming months suggests he may well discuss new or renewed facilities once Janet Yellen is confirmed as Treasury Secretary, but today's exchange provided neither insight nor detail.

With regard to climate risk, Chair Powell also underscored that the Fed will not make determinations as to the credit worthiness of a particular asset, implicitly rejecting efforts by progressive Democrats pressing the central bank to purchase green assets and BIS recommendations (see Client Report **GREEN**) that central banks do so. Further, Mr. Powell said that Fed climate-risk thinking will not affect monetary policy, with the Fed's focus now solely on supervisory and financial-stability considerations.

Recent Files Available for Downloading

The following reports and analyses have been sent to retainer clients recently. Copies are also available to retainer clients on the Archives section of Federal Financial Analytics' website: www.fedfin.com or clients may obtain the reports/analyses by e-mailing requests@fedfin.com giving the requested item name, firm, and e-mail address. To learn more about GSE Activity Reports, click: http://www.fedfin.com/index.php?option=com_content&view=article&id=18&Itemid=18

- **GSE-121620**: Secretary Mnuchin's comments yesterday make it clear – at least mostly – that Fannie and Freddie will remain in conservatorship as the Biden Administration takes charge.
- **REFORM200**: In this report, we continue our 2021 forecasts, moving from our assessment of digital finance (see Client Report **DIGITAL6**) and asset-management regulation (see Client Report **RECOURSE6**) to an assessment of the U.S. capital and liquidity framework for large banks and FBOs.

- **RECOURSE6**: In this report, we assess the regulatory consequences of one of the ironies of March's market turmoil: among the reasons it was not worse is because some large banks stepped in and backed customers or investors despite the lack of any legal obligation to do so.

- **CHARTER28:** Continuing Acting Comptroller Brooks' policy of considering precedent-breaking applications and charters, the agency has received a controversial application from Figure to establish a national bank that, by virtue of this charter, would also be a Fed member.

- **GSE-120720:** The last Trump FSOC annual report reiterates 2019's findings: nonbank originators and servicers are weak and interconnected, thus posing systemic risk.

- **DIGITAL6:** Even though 2020 was of course preoccupied by the pandemic, there was no scarcity of the oft-repeated nostrum that law and rule must define the future of digital finance.

- **CHARTER27**: In conjunction with a wide-open request for views on ways to increase the innovativeness of national banks and federal savings associations (FSAs), the OCC has finalized a significant rewrite of their more traditional powers and activities.

- **GSE-120220**: Today's House Financial Services session with Mnuchin and Powell shed just a bit more light – or provided still more uncertainty – on the critical question of whether Treasury will work with FHFA to end the conservatorships before the Biden Administration surely keeps them for a long, long time.

- **GSE-120120A**: At today's Senate Banking hearing on the CARES-funding fracas, Secretary Mnuchin told Sen. Rounds (R-SD) that the GSEs should be quickly brought out of conservatorship but that they will not be let out without sufficient capital.

- **GSE-120120**: Given the high confirmation odds for Janet Yellen as the nation's next Treasury Secretary, we here assess her impact on the future of U.S. housing finance.

- **ESG3**: Following through on one of his pledges, Acting Comptroller Brooks' agency has issued a controversial proposal to prevent large banks and perhaps all federally-chartered ones from deciding whether or not to grant credit on grounds other than clear, quantitative indicators of ability to repay.

- **GSE-112420**: Building on our analysis of the overall final FHFA capital rule, we turn here to an assessment of the rule's strategic impact.

- **GREEN5**: In its latest report on climate risk, the Financial Stability Board reiterates the complexity of measuring financial-system climate risk, continuing its work to enhance the ability of regulators and financial institutions to do so due to the magnitude both physical and transition risks are likely to pose.

- **GSE-112320:** In this report, we build on our initial summary of FHFA's final capital construct to assess one of the most important issues on which FHFA made at least some concessions.

- **GSE-111920**: On Monday, we reiterated our call that FHFA would move the capital rule ASAP and then end the conservatorship as quickly as possible under terms and conditions designed to make it challenging for the Biden Administration to unravel a fait accompli.

- **GSE-111820**: In its 2020 systemic-risk assessment, the Office of Financial Research takes unusual issue with GSE CRT transactions.

- **SYSTEMIC90**: The Office of Financial Research's latest systemic-risk assessment reiterates much of the market analysis in the FRB's recent report (see Client Report **SYSTEMIC89**), the FSB's analysis (see Client Report **NBFI**), and the OCC's risk matrix.

- **NBFI**: As promised again just last week, the Financial Stability Board today released a "holistic" plan for dealing with NBFIs along with an ambitious agenda for global standards as soon as next year.

- **GSE-111620**: Responding to your requests, this report summarizes and expands on the post-election outlook for U.S. housing policy we've also discussed with many of you since November 3.

- **RESCUE78**: Today's HFSC hearing with federal regulators addressed some of the same ground as the Senate's session earlier this week (see Client Report **RESCUE77**), although Acting Comptroller Brooks did not come in for the shellacking on his innovative charters delivered by Senate Democrats

- **RESCUE77:** At its first hearing following last week's election, Senate Banking today heard testimony from the federal prudential regulators which largely covered ongoing efforts to combat the COVID pandemic's impacts on the financial system.

- **GSE-111020**: Following our in-depth analysis of the Fed's latest financial-stability report, we here focus on mortgage-specific considerations, with the most significant strategic one the Fed's conclusion that nonbank mortgage servicers and MREITs are far from out of COVID's Black Forest.

- **SYSTEMIC89**: In this report, we go in depth into the forward-looking financial-policy implications of the Fed's latest financial-stability report.