

## Flash Note 14/06/2018

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### Is a US dollar liquidity crisis on the cards?

Some voices, the usual ones, begin to warn of the imminent threat of a liquidity crisis in the dollar. I recognize that, at first glance, your arguments may lead one to the temptation to believe that such a threat is true. They adduce the combination of four factors: (1) A huge fiscal deficit in the US that will fight to get the dollars in circulation for financing. (2) The tax reduction in the USA will cause companies to invest (and therefore) get more debt. (3) The Fed no longer buys treasury debt, and we will have to fight for the dollars in circulation. (5) And as if that were not enough, the Fed raises the price of those dollars, which makes them even more coveted.

Are you still there or have you left in despair to place sales orders to liquidate your portfolios?

Set against this the Fed has just renewed its US dollar swap lines with central banks in the eurozone, UK, Canada, Switzerland and Japan. While the renewed agreements do not cover Emerging markets' central banks (except Brazil), it is worth mentioning that during previous episodes of stress, the existence of Fed swap lines has proved effective at containing overseas short-term US dollar funding rates such as Libor.

The swaps are priced at OIS+50bp. Libor and commercial paper rates have marginally exceeded this "cap" on a few occasions, including in recent months. But they didn't exceed it by much, and Libor rates have always retreated soon after.

In short, the Fed's US dollar swap lines work, which should mitigate the chance that higher US dollar borrowing costs will trigger the sort of generalized US dollar funding crisis that so troubles some market participants.

On the other hand, there is the circumstance that in a favorable global cycle environment (as we hope, as a result of observing with our own eyes the underlying dynamics of activity in countries ranging from Latin America to the most remote corner of Asia), and a global cycle in which the US participates, it usually happens that this country incurs a wider current account deficit, increasing the amount of dollars in the world. An environment in which, by the way, emerging countries benefit disproportionately.

Best