Backstopping financial damage from Coronavirus - by Daniel Calano

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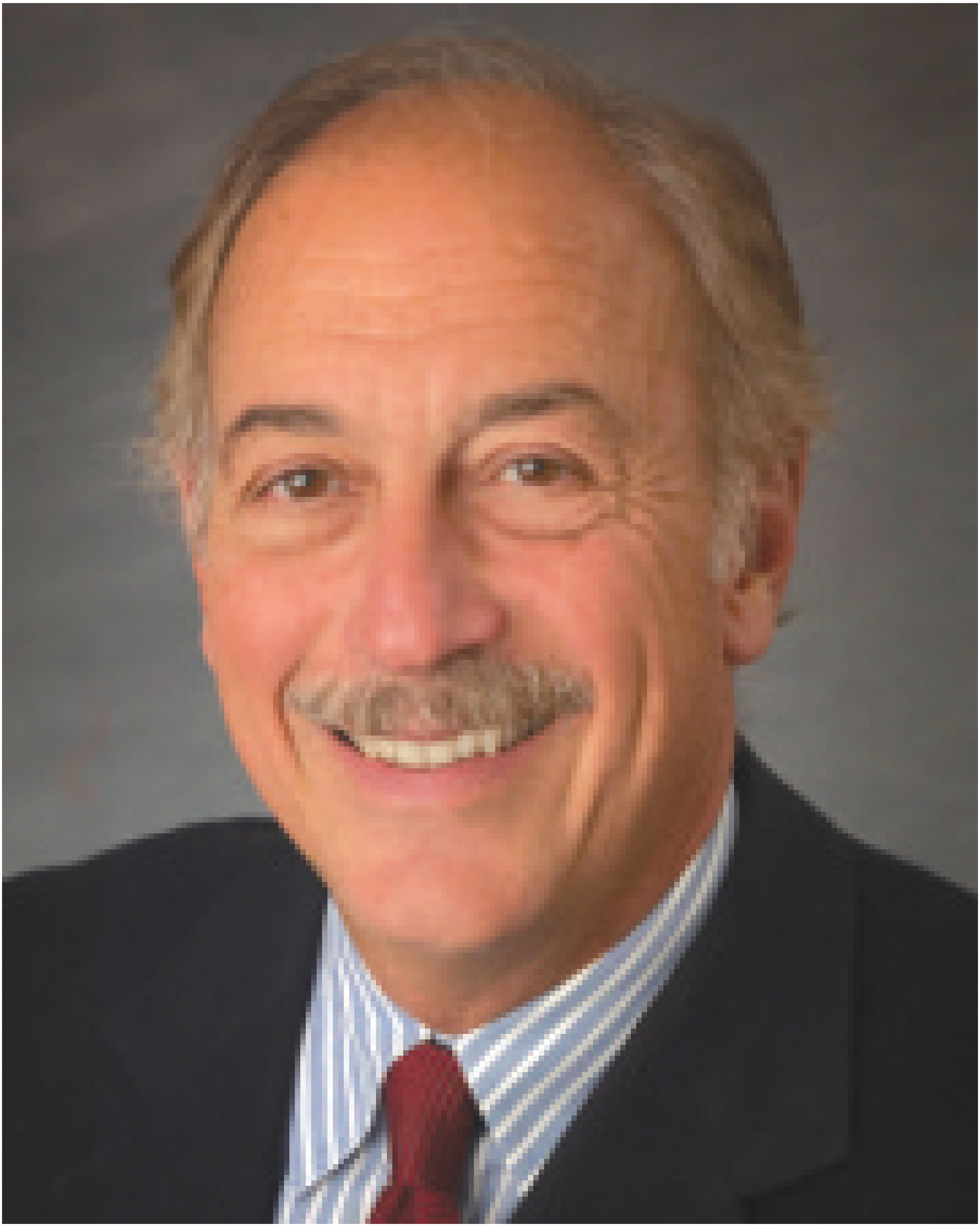

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You may be wondering what our government is doing to provide assistance to our economy, companies, individuals, during the Coronavirus crisis. Let’s start with… it’s a lot. This is a story of what the financial rescue steps are, and how they compare to government efforts during the 2007-2008 Great Recession.

First, a reminder lesson in numbers. Most of us know that $1 billion is 1000 million and looks like $1,000,000,000. Now it gets harder: $1 trillion is 1000 billion and looks like $1,000,000,000,000. Impressive array of zeros! Between Congressional fiscal edicts of over $2.4 trillion, and Federal Reserve monetary incentives of about $4.5 trillion, government has spent $7 trillion over the last two months to “backstop” financial problems stemming from Coronavirus. Absolutely unprecedented, this cost will put us close to a $4 trillion annual deficit this year ($1 trillion is the norm). It’s probably not the final number, and it’s likely less expensive than not doing it. It’s likely a good thing.

So what has the Fed done for me lately? The Brookings Institute has published a responsive recent paper, very insightful, and a great summary. In general, Brookings says the Fed goal has been to keep credit markets liquid and functioning to ensure that households, businesses and governments can survive. According to many, there’s not a lot left the Fed can do with interest rates. Congress, on the other hand, can and has passed legislation for at least $2.4 trillion to support businesses as well as individuals, through direct checks and/or tax credits. Let’s take a very brief look.

First, the Fed recently dropped their short term lending rate by 1.5%, bringing it down to .25%. This is meant to stimulate borrowing, eventually lowering rates on longer-term loans such as mortgages. Unlike in the Great Recession of 2007 – 2009, the Fed has also signaled that they will keep rates low “until confident the economy has weathered recent events.”

Next, the Fed has re-energized Quantitative Easing, a term you may remember from the Great Recession when the Fed bought trillions of long-term securities, such as treasury notes and mortgage-backed securities. This time, the Fed first said it would buy at least $500 billion in treasury and $200 billion in government guaranteed mortgage-backed securities. A few weeks later, it made its purchases open-ended, due to the Corona worsening, and thus signaling unparalleled backstopping and support.

In another program called Repurchase Agreement operations, the Fed provides cash to money markets for firms to borrow overnight in order to increase liquidity. The Fed was offering $100 billion overnight prior to Corona, which it has expanded in both amount and length of loans to $1 trillion overnight with longer payback. Similarly, the Fed has relaunched the recession Money Market Mutual Fund Liquidity Facility which lends to banks collateralized by money market fund assets. This is to convince investors that money market funds will not collapse, and hopefully investors will not panic and pull out reducing values.

In vivid contrast to the Great Recession, the Fed is now encouraging banks to relax regulatory requirements. Regulations after the recession required large capital buffers to be held by banks. The Fed is now encouraging banks to lower their reserve requirement.

Going beyond recession programs, the Fed has established new facilities to lend directly to corporations. Borrowers may defer interest and principal payments for at least six months, thus allowing companies access to credit so that they are better able to maintain operations during the pandemic. The Fed started with $100 billion and recently moved it to $750 billion.

As well touted in the news, the Fed and Congress have established a Main Street Loan Facility program. Through banks, the Fed will fund 95% of loans, initially up to $600 billion in loans. On top of that, the Fed created paycheck protection program (PPP) specifically for small businesses to keep employees during this crisis. $75 billion is allocated to that at this point. In addition to everything else, the Fed is backing up municipal bond liquidity through direct lending to state and local governments. This program is offering up to $500 billion to municipalities, but it is clear that will be increased.

The list goes on, and there is lots more in the details. It is clear that the Coronavirus crisis is being funded significantly higher than anything done during the recession. Most believe this is a good and absolutely necessary thing. That said, others are worried appropriately about the amount of debt and liabilities we are creating. It seems, however, we have no other alternatives, and this crisis may need everything already done and then more. No one yet knows the amount of financial damage caused by the virus, or the results of our enormous response. Let’s hope for a scientific solution, i.e. vaccination, to this soon.

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