US: The Fed's words and actions

Fed Chair Jerome Powell's speech and another package of measures from the central bank reinforce the view that officials will do whatever is necessary to prevent financial and credit market strains from compounding the economic dislocations from Covid-19

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Doing whatever it takes...

In another busy morning for the Federal Reserve we have seen it expand its tool kit further by announcing a US$2.3 trillion package, including loans for small businesses and municipalities to help bridge the economic disruption caused by the Covid-19 pandemic. We have also heard directly from Fed Chair Jerome Powell in a webcast about the importance of fiscal policy working together with monetary policy at this current time of crisis.

Powell argues that the Fed's direct responsibility is "providing a measure of relief and stability... and by using our tolls to ensure that the eventual recovery is as vigorous as possible". In this regard he focuses on the policy measures of rate cuts and asset purchases in an effort to "safeguard financial markets in order to provide stability to the financial system and support the flow of credit in the economy".

The toolbox keeps getting bigger

Additionally, he emphasised the importance of their "emergency lending powers", which include today's announced measures to support small businesses and local government. Backed up by US$75bn of capital from the Treasury, the Fed will purchase up to US$600bn of "main street" small business loans and will also set up a "Municipal Debt Facility" offering up to US$500bn in loans, backed by US$35bn of Treasury capital.

The Fed is also expanding previously announced primary and secondary market credit facilities and the GFC era TALF programme up to US$850bn, backed by US$85bn of Treasury capital. This will allow additional purchases of various asset backed securities (such as student loans, car loans and lending conducted through the Small Business Association). According to the Fed this will, "increase the flow of credit to households and businesses through capital markets".

Rounding out the initiatives (and getting us to US$2.3tr) the Fed detailed the US$350bn lending fund designed to provide loans to small businesses so that they can keep their workers on the payroll. This was initially announced within the US$2tr fiscal package with the Fed helping banks by extending credit to "eligible financial institutions that originate loans, taking the loans as collateral at face value" thereby allowing the banks to remove them from their balance sheet. This should boost incentives to participate in the scheme and reduce the chances of credit being constrained to other areas.

Powell emphasised that the Fed only has lending powers. It does not have spending powers and cannot grant money, adding that there will be many "entities of various kinds that need direct fiscal support rather than a loan they would struggle to repay".

> *The Fed to use its lending powers 'forcefully, proactively and aggressively'*

Nonetheless, the Fed will continue to use its lending powers "forcefully, proactively and aggressively until we are confident that we are solidly on the road to recovery".

The long road to recovery

In terms of the economic outlook, Jerome Powell notes that the US is heading to a "very high unemployment rate... with alarming speed" – see our earlier note on jobless claims where we suggest the unemployment rate is currently around 14% – but that "the economic rebound, when it comes, will be robust". He believes monetary policy is in a good place and they will not be considering changing interest rates in the next few months.

We do not expect to see an interest rate change for at least twelve months. While there is evidence that the virus threat may be beginning to subside, the US remains a long way from a full re-opening and even longer from a return to "business as usual". We will be closely following how Austria and the Czech Republic unwinding of the lockdown proceeds and have to be congnisant of the risk that should virus cases pick up again their could be renewed shutdowns, such as seen in Singapore this week.

Our base case is that we start to see a rolling process of re-opening in the US from mid-May, but one that still involves some form of social distancing with stricter testing coming into place. This means job opportunities for the millions of workers laid-off, particularly in the leisure & hospitality, retail and transport sectors will remain somewhat limited and unemployment will be slow to fall.

We also have to recognise the risk that numerous companies don't make it through this crisis, despite the Fed and government support mechanisms, and many that do will need to restructure. Should business failures lead to higher non-performing loans this will adversely impact banks and could hurt credit availability, which further limits the scope for a vigorous economic revival.

Given this backdrop, we tentatively suggest that the economy contracts more than 12% peak to trough, compared to the 4% contraction experienced during the Global Financial Crisis, with the lost output not fully recovered until mid-2022.

Author

James Knightley
Chief International Economist
james.knightley@ing.com