

# A Tale of Two Sides



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In light of the devastating health crisis and a shutdown which has quickly led to record job losses, the Federal Reserve launched new programs at the same time the jobless claims report was released this morning. With over 16 million people filing for unemployment insurance benefits in the last three weeks, and more to come, it has spurred the Fed into high gear “within the confines of the law.” Today, they launched several additional actions that allows the Fed to provide up to **\$2.3 trillion in loans to help credit flow to households and businesses.**

## Main Street Lending Program

The Fed initiated this program, which will purchase from banks and other financial institutions up to \$600 billion in 4-year term loans, to support credit flowing to small and mid-sized businesses:

- Eligible borrowers “**must make reasonable efforts** to maintain its payroll and retain its

employees during the 4-year term of the loan.”

- Eligible borrowers are businesses with up to 10,000 employees or up to \$2.5 billion in 2019 revenues.
- Loan size is \$1 million and can be as large as \$25 million.
- These companies must have most of their employees based in the US.
- If a company participates in this program, they may not double or triple dip access to other Fed lending facilities.
- There are a host of restrictions on this borrowing, including a provision which requires borrowers to follow the executive compensation, stock buybacks, and dividend policies stipulated in the CARES Act.
- These borrowers must demonstrate that their businesses have been impacted by COVID-19.

## **Paycheck Protection Program Liquidity Facility**

This facility is really designed to provide ample credit flows to banks who are administering the \$350 billion of SBA loans in the CARES Act. The plumbing here is straightforward; banks have a bunch of SBA loans they are booking. They take these loans to the Fed and, in exchange, the Fed provides loans to the banks so they can distribute the loan proceeds to small businesses. It is yet one more way the Fed is the backstop for credit flowing to banks so they can help households and businesses.

## **Primary and Secondary Market Corporate Credit Facilities**

This has been such a whirlwind, but on March 23, the Fed initiated two facilities to buy corporate bonds, both new and existing. This was an effort to help investment-grade companies get funds they need through their bond issues in order to support operations. However, the Fed expanded these facilities to allow companies whose bond ratings slipped below investment grade since March 22 to qualify. These facilities now have expanded capacity: up to \$750 billion of lending. Of all the programs, these two are designed to help large corporations hit by steep slides in the value of their bonds. This is an important effort since these companies have also been hit by stock price collapses, thereby shutting off the capital access spigot abruptly.

## **Term Asset Backed Securities Loan Facility**

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The Fed initiated this facility on March 23 but has now extended its reach today. The amount of lending is still set at \$100 billion of 3-year loans, but the range of eligible assets has been expanded greatly. Asset backed securities are an important part of the credit market because it is a way for companies to finance auto loans, student loans, and credit cards. Today the Fed added many more types of asset-backed securities that have underlying credit exposures. In all, there are now nine different types of loans supported by this facility.

## **Municipal Liquidity Facility**

Perhaps one of the most important programs to be announced, the Fed will now offer up to \$500 billion in lending to states and municipalities, both city and county. But there are restrictions on how these municipalities can use the funds. For example, the funds must be used to help manage the cash flow effects of:

- Income tax deferrals due to the filing deadline extensions;
- Outright tax losses due to COVID-19; and
- Principal and interest payment obligations coming due.

While the program is slated to end on September 30, 2020, they certainly leave open the possibility that the Fed and US Treasury Department could extend it.

## **Recap – Two Sides**

It is daunting to look at the degree of policy thrust from the Federal Reserve as compared to what the US federal government has pushed out on the fiscal side. There is no question that both are aggressive and, with any benchmarks, far outstripping what has been done in past generations. The health crisis prompted an enormous policy response.

After the Federal Reserve announcement today, they are now exceeding well over \$10 trillion of support to all types of businesses—small, medium, and large businesses, banks, mortgages, Treasury securities, fallen angels, still-healthy companies, global companies, domestic ones, captive finance companies. The Fed has provided near unlimited dollars to foreign central banks grappling with the sheer scarcity of US dollars in financial markets as investors scramble to sell, sell, sell.

Now flip over the fiscal side: \$8.3 billion of emergency funding on March 6, \$50 billion of emergency funding under the Stafford Act on March 13<sup>th</sup>, \$192 billion of funding for paid sick leave and other short-term support on March 18, and finally about \$2.2 trillion in the CARES Act on March 27<sup>th</sup>.

So what's the score?

Federal Reserve: \$10+ Trillion\*

Federal Government: \$2.3 Trillion

\*Includes an estimate of asset purchases, lending and liquidity facilities since the health crisis began

And I know, the Fed is lending, and purchasing financial assets, not giving away money. At the same time, \$450 billion in the CARES Act is credit protection for the Federal Reserve's Main Street Lending Program, unveiled today. That spending could be put in the Federal Reserve column.

The health crisis is an economic disaster. Fiscal policy beyond any we have seen is required. The rule books don't apply right now. We are now risking a full-blown deep depression without a more significant, targeted fiscal support. This is a big deal.