# US Policy Response to COVID-19

NBER COVID-19 Policy Panel

Nellie Liang

Senior Fellow, Brookings Institution

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# US COVID-19 response

- Health care response is paramount
- Fiscal – CARES Act $2.2 T on Mar 27
  - Health, Unemployment, Direct payments
  - $349 for PPP (subsequently increased) and $500 B for business loans
- Financial stabilization policies
  - Monetary policy – Rate cuts start Mar 3
  - Emergency liquidity measures
    - To “break the panic” when can’t price risk because of high uncertainty
    - Prevent liquidity stress from becoming insolvency
    - Provide a bridge to a government transfer or more permanent solution
  - Macroprudential policies – ease pre-existing buffers and forbearance

# Financial stabilization in 2020

- Approach is different from 2008
  - More aggressive, crisis did not originate in the financial sector
- But goals are similar
  - Limit immediate damage and position the economy to recover quickly
- Financial instability = Extreme shock * Moderate financial vulnerabilities
  - Financial vulnerabilities amplified the extreme corona virus shock
  - Most surprising – Market dysfunction for Treasury and investment-grade bonds; fire sales by hedge fund and m_REITs
  - Less surprising but destabilizing – investor runs on prime MMFs; large redemptions from bond MFs
  - Bright spot - Banking sector resilience

# Fed emergency liquidity responses

- Authorities – Direct or 13(3)
  - Fed can purchase US government securities
  - Lend freely against collateral to financial firms facing liquidity strains
  - Lending under 13(3) - determine unusual and exigent circumstances and extend credit "secured to its satisfaction"
- Market-maker of last resort and Lender of last resort
  - ~ $3.0 T (as of 6/24)
  - Purchases and repo of Treasuries and agency securities
  - Dollar swap lines and dollar repo
  - Discount window, primary dealer credit facility, money market, PPP facility

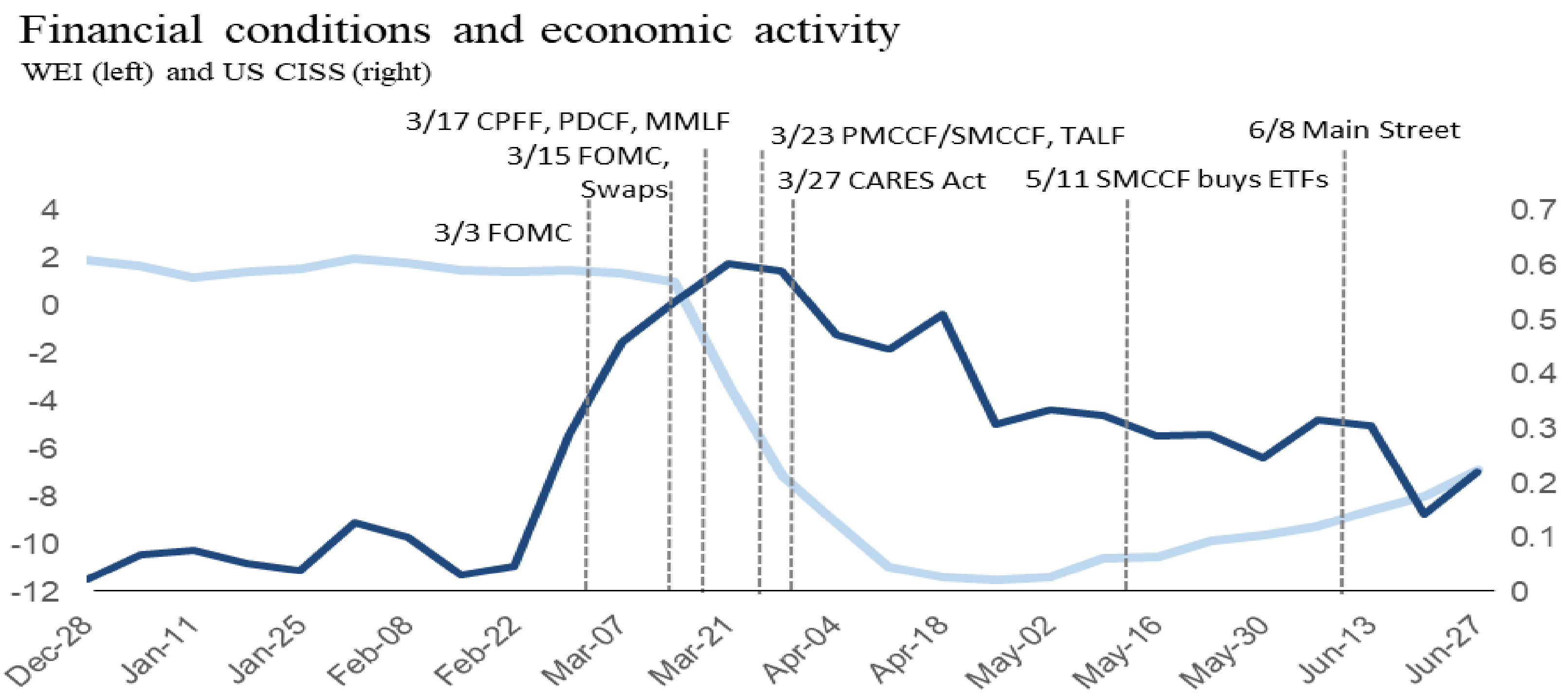
# Fed 13(3) Credit facilities

- New facilities to support businesses and municipalities
  - Mainly backstops or last-resort financing
  - Business borrowers have limits on exec comp, dividends, share repurchases
  - Amount disbursed ~$14 B (as of 6/24)
- Corporate credit
  - $8.7 B (up to $750 B with Treasury capital $75 B)
  - PMCCF – purchase new issues from inv-grade and fallen angel borrowers
    - Backstop like CPFF, at terms more expensive than in normal market conditions
  - SMCCF - purchase bonds and bond ETFs in the secondary market to support market functioning and new issuance
- Municipal
  - $1.2 B (up to $500 B with Treasury capital $35 B)
  - Purchase new issue notes – tax anticipation, revenue anticipation, etc – of up to 3 years
  - Terms more expensive than in normal market conditions

# 13(3) Credit facilities (cont)

- Main Street ($0, up to $600 B, Treasury capital $75 B)
  - Banks underwrite loans to small- to mid-sized businesses, and subject to Fed/UST underwriting
  - Retain 5% and sell 95% to Fed/UST (English and Liang, 2020)
  - Need to lend to be effective
  - But loans cannot be forgiven, so may not help many firms
  - Congress should consider other options- state contingent insurance, preferred stock - if more businesses need help

# Financial conditions and policy actions




Source: US CISS from ECB Statistical Data Warehouse. Lewis, Mertens, and Stock, Weekly Economic Index, https://www.newyorkfed.org/research/policy/weekly-econoimc-

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# Banks and feedback to the macroeconomy

- US banks resilient so far, with Basel III reforms and stress tests
  - Macroprudential goals - banks in stress can absorb losses and not cut back lending
- Bank stress tests 2020
  - Macro stress scenarios provided to banks in Feb 2020, before pandemic
  - Could have revised scenarios and asked banks for new capital plans in Mar / April
  - Instead analyzed bank capital in three alternative scenarios: V-, U-, and W-shaped recoveries, with bigger balance sheets and targeted weak industries
    - Not release firm-level results, but show a wide range of outcomes
    - For W- recovery, 25$^{th}$ percentile is near 4.5 percent (min req) and 75$^{th}$ is near 10 percent
- Capital requirements determined for each firm, as per rule, by a full stress test based on Feb scenarios

# Will banks remain resilient?

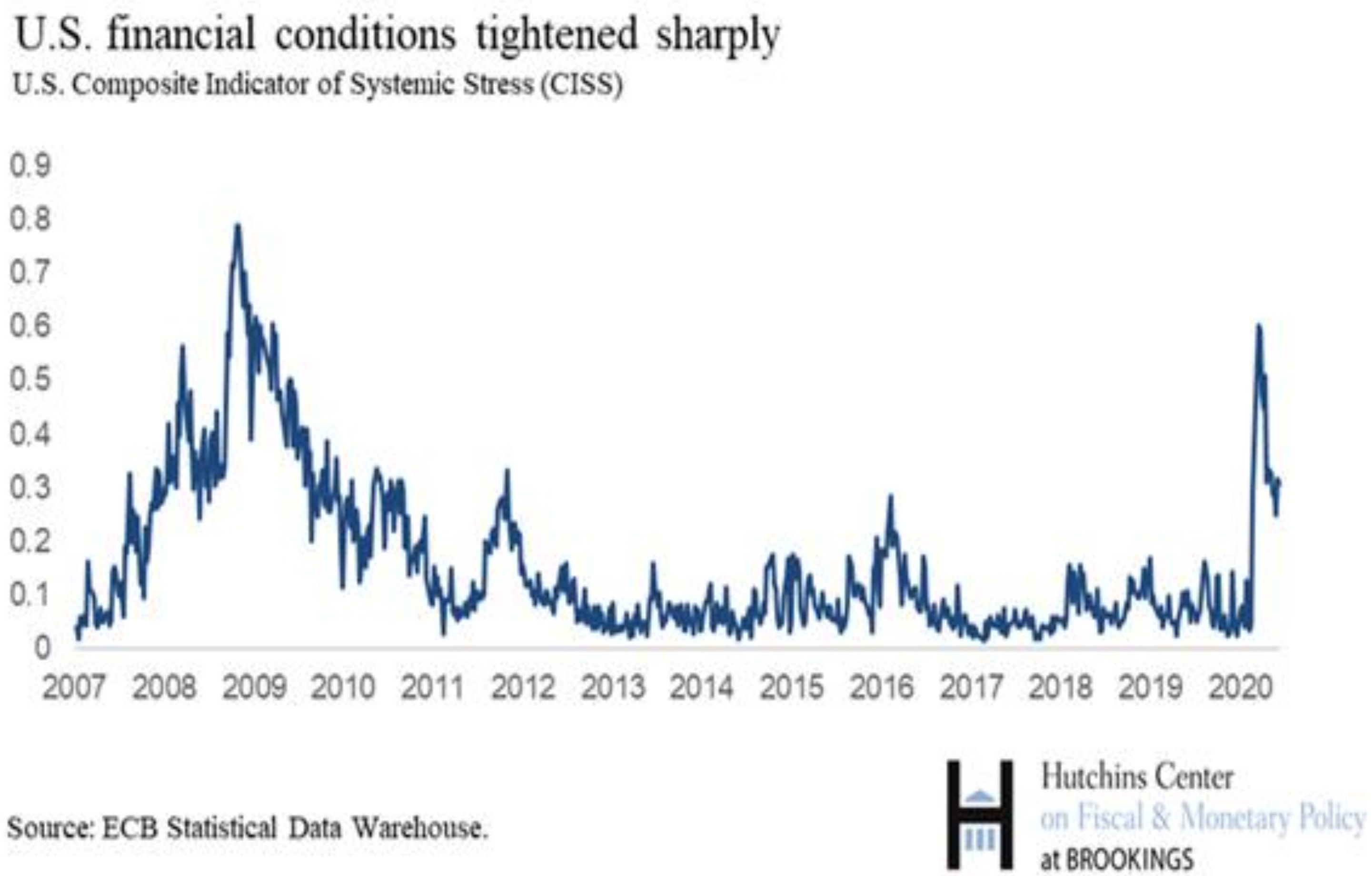
- Actions taken
  - Suspended share repurchases and capped dividends for 2020 Q3 for all banks
    - Repurchases ~ 70 percent of distributions in 2019 (Kohn and Liang, 2019)
  - Limit dividends to amount based on recent earnings
  - Require banks to resubmit new capital plans later this year
  - Board will conduct additional analysis each quarter
- Should they have shut off dividends for all banks?
  - Some firms will need more capital under alternatives, and don’t want to reveal the weak (Blank, Hansen, Stein, Sunderam, 2020)
  - Process to limit dividends along with disclosures is enough, absent more clarity about the economy

# Longer-run challenges

- Moral hazard, though current reason for intervention differs from 2008
  - Reduced downside tail risk
  - Fed ventured further into credit (corporate and muni bonds, Main Street) this time
- Need to reduce financial vulnerabilities before next time
  - Markets and market-based finance
    - Treasury market structure resilience
    - Prime MMFs gates
    - Open-end bond funds with daily redemptions
    - Limited data on fund leverage
  - Banks
    - Leverage ratio
    - Stress tests, usability of buffers, and TBTF

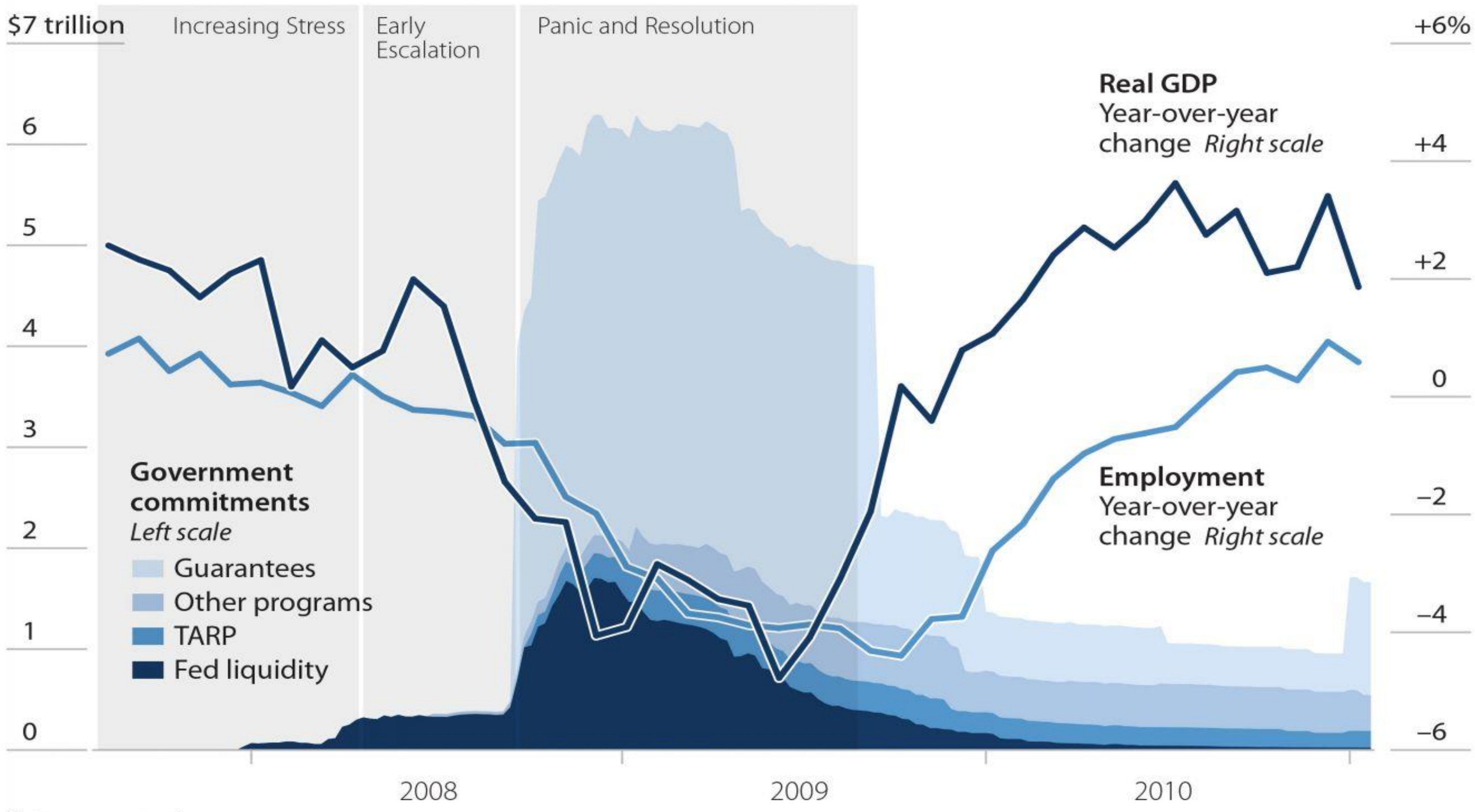
# Appendix

# Composite indicator of systemic stress




- Index of five components
  - Money market
  - Equity markets (nonfinancial corps)
  - Bond markets (government and nonfinancial corps)
  - Foreign exchange markets
  - Financial intermediaries
- Higher when more components high at the same time

## Government Commitments for Systemic Policies and GDP and Employment Growth




Notes: see second page.

Sources: Figure 18.5, J. Nellie Liang, Margaret M. McConnell, and Phillip Swagel, "Evidence on Outcomes," in Ben S. Bernanke, Timothy F. Geithner, and Henry M. Paulson, Jr., with J. Nellie Liang, eds., *First Responders: Inside the U.S. Strategy for Fighting the 2007–2009 Global Financial Crisis* (New Haven: Yale University Press, 2020). U.S. government exposures: Congressional Oversight Panel, "Guarantees and Contingent Payments in TARP and Related Programs" via Federal Reserve Bank of St. Louis, Federal Deposit Insurance Corp., Federal Reserve Board, Federal Housing Finance Agency, U.S. Treasury; employment: Bureau of Labor Statistics; real GDP: Macroeconomic Advisers via Haver Analytics



First Responders, eds Bernanke, Geithner, Paulson, with Liang, 2020