Federated Hermes

As Congress debates stimulus, Fed marches forward

Policymakers keep coming up with more ways to support markets and economy.

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R.J. Gallo, CFA
Head of Municipal Bond Investment Group

The Federal Reserve expanded and announced more financial market and economic support programs to start the week. Specifically, expanding on last week's announced plan to buy at least $500 billion of Treasury securities and $200 billion of mortgage-backed securities (MBS), the Fed today pledged to buy unlimited amounts of Treasury and MBS in a strong step dubbed as "QE-infinity" by some in the market.

Fed actions so far

- Began open-ended purchases of U.S. Treasuries and agency MBS, to include agency commercial MBS.
- Announced purchases of at least $500 billion of Treasury securities $200 billion of MBS.
- Created new programs that, combined, will provide up to $300 billion in new financing to supporting the flow of credit to employers, consumers and businesses help.
- Established two facilities to support credit to large employers—the Primary Market Corporate Credit

Importantly, the Fed also expanded market support for a range of fixed-income sectors, introducing direct or indirect purchases of corporate bonds, agency commercial MBS and asset-backed securities backed by an array of consumer loans and business loans. Policymakers also expanded the eligible securities in the previously announced **Money Market Liquidity Facility** to include municipal variable-rate demand notes and certificates of deposit. In sum, the Fed will soon be more boldly using its balance sheet and an alphabet soup of programs to provide direct or indirect purchases of a wide range of credit instruments to aid corporations, households, municipal governments and businesses at this challenging time.

At this writing, we're hopeful Fed policymakers will soon announce purchases of longer-term municipal securities as well, a step that requires either an act of Congress to amend the Federal Reserve Act or declaration of exigent circumstances invoked to support other recent

Facility (PMCCF) for new bond and loan issuance and the Secondary Market Corporate Credit Facility (SMCCF) to provide liquidity for outstanding corporate bonds.

- Established the Term Asset-Backed Securities Loan Facility (TALF) to support the flow of credit to consumers and businesses by enabling the issuance of asset-backed securities backed by student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration (SBA) and certain other assets.
- Established the Money Market Liquidity Facility (MMLF) to enhance secondary market liquidity in the short-term high-quality money markets, which later was expanded to include municipal variable-rate demand notes and bank certificates of deposit.
- Facilitated the flow of credit to municipalities by expanding the Commercial Paper Funding Facility (CPFF) to include high-quality, tax-exempt commercial paper as eligible securities.
- Expected to announce soon the establishment of a Main Street Business Lending Program to support lending to eligible small-and-medium sized businesses, complementing efforts by the SBA.
- Also expanded central bank liquidity swap lines; enhanced the availability and eased terms for borrowing at the

programs. A provision allowing this change is expected in bailout legislation currently being discussed in Congress, although it remains unclear. The Fed already can buy muni securities with maturities up to six months and last week expanded its money market facility to include short-term municipal notes. Muni credits are facing significant financial pressures, with, for instance, sales and income tax revenues falling for state & local governments, public health expenditures rising, revenues at airports declining and not-for-profit hospitals struggling with uncertain shifts in costs and revenues for treating Covid-19 cases.

discount window; eliminated reserve requirements; and cut the federal funds target range to 0-0.25%.

Social distancing—which includes widespread business, school and event closings and is precipitating widespread layoffs—has brought much of the economy to a virtual halt. The prospect of a record economic contraction is sowing fear and causing virtually all asset classes except for U.S. government money market funds to suffer record levels of outflows. At some point, we will be able to start focusing on how we get back to normal. But until we do, massive Fed credit intervention and large government stimulus are needed to provide, essentially, a huge bridge loan to the economy. The Fed seems to be meeting this challenge, and Congress and the president seem likely to step up next.

TAGS

CORONAVIRUS | FIXED INCOME | MONETARY POLICY | VOLATILITY

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The value of some mortgage-backed securities may be particularly sensitive to changes in prevailing interest rates, and although the securities are generally supported by some form of government or private insurance, there is no assurance that private guarantors or insurers will meet their obligations.

Variable rate demand notes are tax-exempt securities that require the issuer or a third party, such as a dealer or bank, to repurchase the security for its face value upon demand. The securities also pay interest at a variable rate intended to cause the securities to trade at their face value.

Federated Investment Management Company

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