Economic Analysis

Fed takes further action to contain economic fallout

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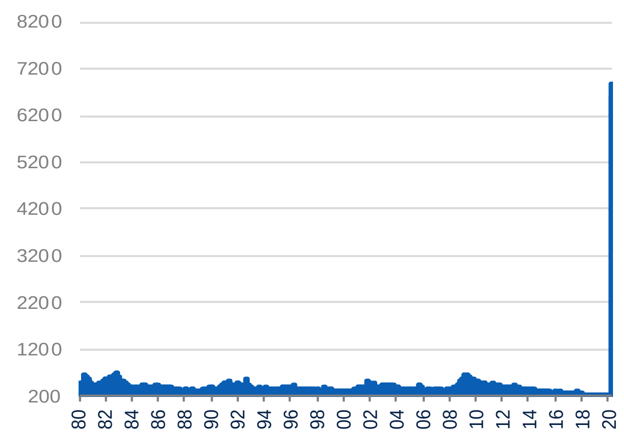
Initial jobless claims for the week ending on April 4th nearly matched the historic surge from the prior week with 6.6M people filing for unemployment benefits; last week's claims were also revised up to 6.8M. The number of individuals receiving continuing benefits reached 7.5M, surpassing the peak of the financial crisis (6.5M) while the share of individuals receiving benefits reached 5.1% of covered employment.

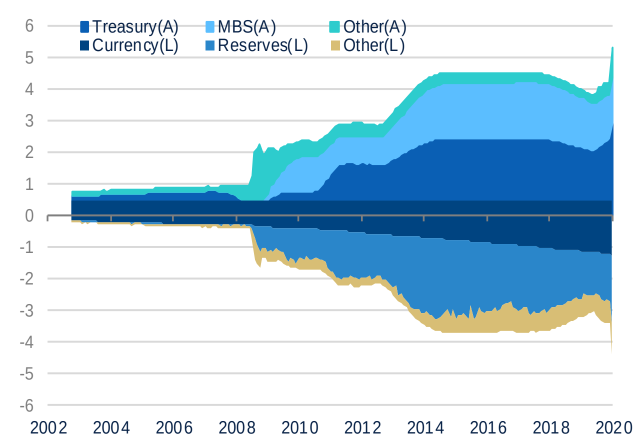
While the impact from COVID-19 continues to grow with areas around the country expanding containment efforts, there has already been an unprecedented contraction in the labor market. Over the past three weeks, 16.8M people have filed for unemployment insurance, representing more than 10% of the U.S. labor force. While staggering, there is a high probability that furloughs and separations will continue to increase over the next few weeks. Based on a back of the envelope calculation, with the reduction in capacity at the industry-level there is a chance that in an extreme case over 40M people (25% of total labor force) could be unemployed with 5 industries accounting for around 60% of the job losses.

Figure 1. **Initial Unemployment Insurance Weekly Claims,** (thousands)



Source: BBVA Research, DOL and Haver Analytics

Figure 2. **Fed Balance Sheet** (US$tn)



Source: BBVA Research, FRB and Haver Analytics

In response to the dire conditions in the labor and financial markets, the Fed announced a $1.8tn expansion of the emergency credit programs. Combining today's announcements to existing facilities gives the Fed a $2.3tn in fire power to support funding and credit conditions.

First, the Fed expanded the corporate credit programs by $750bn and broadened the scope of securities available that have access to the facility (ETFs that invest in high-grade debt and companies rated at least BBB- on March 22).

Second, it expanded the list of eligible collateral in TALF to include triple-A rated tranches of both CMBS and newly issued CLOs -the size of TALF remains at $100bn. Third, the Fed established a Municipal Liquidity Facility to support lending to states, cities and counties. This facility will have $35bn in equity to purchase up to $500bn in eligible securities. Fourth, the Fed provided details on the Main Street Expanded Loan Facility, intended to facilitate lending to SMEs on a recourse basis. The facility will purchase 95% of the eligible loans, with 5% participation retained by the lending institution. The Fed will use $75bn under the CARES Act as equity investment to support $600bn in lending.

Chairman Powell, in his first speech since the COVID-19 financial, economic and health contagion reached the U.S., stressed the importance of policymakers saying that “delivering financial support directly to those most affected falls to elected officials.” For the Fed, the reduction in interest rates and commitment to keep rates low “until we are confident that the economy has weathered the storm and is on track to achieve our maximum-employment and price-stability goals” was buttressed by safeguarding against a collapse in financial markets. In fact, the Chairman emphasized that the latter has been an even more important task.

In the minutes from the March 15th meeting, the prevailing theme was one of uncertainty. While the committee clearly saw the risks to the U.S. economy were growing, based on the discussions it appears that the members had not fully grasped the magnitude of the crisis evidenced by the expansion of accommodation announced in the following weeks that saw the commitments to treasury and MBS purchases rise from $500 bn and $200 bn, respectively, to “in the amounts needed”.

Powell’s speech reiterated that the current measures taken are not within the realm of spending, but rather fall within the scope of the Fed’s authority and are not directed “to particular beneficiaries.” Given the complexity and scope of the Fed’s current initiatives and the risk of attacks on the Fed down the road this was to be expected. Despite the Fed broadening the coverage and increasing the size of emergency lending, more may still be needed.