Special Commentary

Jay H. Bryson, Acting Chief Economist
jay.bryson@wellsfargo.com • (704) 410-3274

The Fed Goes Nuclear: Part II

The Federal Reserve announced a series of measures this morning that are intended to assist households, businesses and state & local governments as they cope with the economic fallout of the COVID-19 outbreak. The Fed estimates that the programs will provide an additional $2.3 trillion worth of financial support. The Federal Reserve provided details today of a new program it foreshadowed when it announced a series of measures on March 23, which we discussed in a report we wrote that day. The Fed also expanded some of the programs that it put in place on March 23. We welcome these measures because they should provide further liquidity support to capital markets and help businesses that may be struggling to stay afloat while many parts of the economy remain on lockdown.

The Main Street Lending Program will make loans to businesses.

The most important new measure is the Main Street Lending Program, which the Fed noted on March 23 would be forthcoming. The program will make four-year loans to businesses that have up to 10,000 employees or revenues of less than $2.5 billion. The businesses must have been "in good financial standing" before the crisis, and they must commit to make "reasonable efforts" to maintain payrolls and retain workers. Businesses will receive loans from commercial banks, which will retain a 5% stake and sell the remaining 95% to the Main Street Lending facility, which will purchase up to $600 billion in loans. The idea behind the Fed buying 95% of the loans is so that banks can keep as much room as possible on their balance sheets for additional lending. The Fed will defer principal and interest payments for one year. The facility is being capitalized by a $75 billion equity position that is provided by the U.S. Treasury Department via funding from the CARES Act.

The Fed will be supporting the PPP.

The Federal Reserve will also be providing support to the Small Business Administration's Paycheck Protection Program (PPP) that was also authorized under the CARES Act. The PPP is a $350 billion facility that will make loans, via the commercial banking system, to small businesses. The Federal Reserve will support the PPP via generous liquidity support to financial institutions that participate in the PPP. Specifically, the Fed will extend credit to these institutions at only 35 bps, and it will take the PPP loans as collateral. There is no fee that institutions need to make to participate in the facility, and the PPP loans they make will have a zero percent risk weighting. That is, they will be treated the same way as U.S. Treasury securities are for regulatory capital purposes. As we discussed in a recent report, Congress likely will increase the size of the PPP if, as we expect, it eventually passes a "Phase 4" fiscal package.

The Fed will offer financial support to states and municipalities.

The Federal Reserve will also offer support to cash-strapped municipalities via a Municipal Liquidity Facility. The facility will buy up to $500 billion worth of short-term notes issued by states, counties with populations of at least two million people and cities whose populations exceed one million people. The Treasury Department will offer up to $35 billion worth of credit protection to the Fed for the facility. The Fed also said that it is prepared to take further steps, if needed, to provide liquidity support to the primary and secondary markets for municipal securities.

Finally, the Federal Reserve enhanced a number of programs that it had created on March 23. The Fed established the Primary Market Corporate Credit Facility (PMCCF) to support primary issuance in the investment grade corporate bond market and the Secondary Market Corporate Credit Facility (SMCCF) to provide liquidity support to trading in investment grade corporate bonds. Initially, the Treasury Department capitalized the PMCCF and SMCFF with $10 billion equity investments to each facility. The announcement today indicated that the equity investments would rise to $50 billion for the PMCCF and $25 billion for the SMCCF. This combined capitalization will allow the Fed to purchase up to $750 billion worth of investment grade corporate bonds. Additionally, the Fed indicated that it would begin to dip its toes into the high yield bond market with SMCCF purchases of exchange-traded funds (ETFs) that have exposure to high yield corporate bonds.

Although the Federal Reserve did not increase the size of its Term Asset-Backed Securities Loan Facility (TALF), which provides liquidity support to the securitization markets, the Fed expanded the range of securities that will be eligible for financing. Not only will the TALF make loans to institutions that securitize student loans, auto loans, credit card loans and other similar types of loans, but triple-A rated tranches of both commercial mortgage-backed securities (CMBS) and collateralized loan obligations (CLOs) are now eligible for TALF support. The TALF will make loans up to $100 billion, and it is capitalized by a $10 billion equity investment by the Treasury Department.

The degree of cooperation between the Fed and the Treasury is remarkable.

As noted at the beginning, we welcome these steps that the Federal Reserve announced this morning to support the flow of credit to households and businesses as they cope with the economic fallout from the COVID-19 outbreak. What is remarkable is the degree of cooperation between the Federal Reserve and the Treasury Department that is evident in today's announcement. Specifically, the Treasury Department is providing equity that the Fed can then lever to increase the amount of financial support to households and businesses. In our view, the Treasury Department and the Federal Reserve will continue to do "whatever it takes" to see the economy through its current rough patch, and it is a reason why we believe the economy will begin to recover later this year, as we detail in our latest *Monthly Economic Outlook*.

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Acting Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

WELLS FARGO SECURITIES