Testimony

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Coronavirus and CARES Act

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Chairman Crapo, Ranking Member Brown, and other members of the Committee, thank you for the opportunity to discuss the extraordinary steps the Federal Reserve has taken to address the challenges we are facing.

I would like to begin by acknowledging the tragic loss and tremendous hardship that people are experiencing both here in the United States and around the world. The coronavirus outbreak is, first and foremost, a public health crisis, with the most important responses coming from those on the front lines in hospitals, emergency services, and care facilities. On behalf of the Federal Reserve, let me express our sincere gratitude to those individuals who put themselves at risk day after day in service to others and to our nation.

The forceful measures that we, as a country, are taking to control the spread of the virus have substantially limited many kinds of economic activity. Many businesses remain closed, people have been advised to stay home, and basic social interactions have been greatly curtailed. People have put their lives and livelihoods on hold at significant economic and personal cost. All of us are affected, but the burdens are falling most heavily on those least able to carry them.

It is worth remembering that the measures taken to contain the virus represent an investment in our individual and collective health. As a society, we should do everything we can to provide relief to those who are suffering for the public good.

Available economic data for the current quarter show a sharp drop in output and an equally sharp rise in unemployment. By these measures and many others, the scope and speed of this downturn are without modern precedent and are significantly worse than any recession since World War II. Since the pandemic arrived in force just two months ago, more than 20 million people have lost their jobs, reversing nearly 10 years of job gains. This precipitous drop in economic activity has caused a level of pain that is hard to capture in words, as lives are upended amid great uncertainty about the future. In addition to the economic disruptions, the virus has created tremendous strains in some essential financial markets and impaired the flow of credit in the economy.

The Federal Reserve's response to this extraordinary period has been guided by our mandate to promote maximum employment and stable prices for the American people, along with our responsibilities to promote stability of the financial system. We are committed to using our full range of tools to support the economy in this challenging time even as we recognize that these actions are only a part of a broader public-sector response. Congress's passage of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was critical in enabling the Federal Reserve and the Treasury Department to establish many of the lending programs that I discuss below.

In discussing the actions we have taken, I will begin with monetary policy. In March, we lowered our policy interest rate to near zero, and we expect to maintain interest rates at this level until we are confident that the economy has weathered recent events and is on track to achieve our maximum-employment and price-stability goals.

In addition to monetary policy, we took forceful measures in four areas: open market operations to restore market functioning; actions to improve liquidity conditions in short-term funding markets; programs in coordination with the Treasury Department to facilitate more directly the flow of credit to households, businesses, and state and local governments; and measures to allow and encourage banks to use their substantial capital and liquidity levels built up over the past decade to support the economy during this difficult time.

Let me now turn to our open market operations and the circumstances that necessitated them. As tensions and uncertainty rose in mid-March, investors moved rapidly toward cash and shorter-term government securities, and the markets for Treasury securities and agency mortgage-backed securities, or MBS, started to experience strains. These markets are critical to the overall functioning of the financial system and to the transmission of monetary policy to the broader economy. In response, the Federal Open Market Committee undertook purchases of Treasury securities and agency MBS in the amounts needed to support smooth market functioning. With these purchases, market conditions improved substantially, and thus we have slowed our pace of purchases. While the primary purpose of these open market operations is to preserve smooth market functioning and effective policy transmission, the purchases will also foster more accommodative financial conditions.

As a more adverse outlook for the economy associated with COVID-19 took hold, investors exhibited greater risk aversion and pulled away from longer-term and riskier assets as well as from some money market mutual funds. To help stabilize short-term funding markets, we lengthened the term and lowered the rate on discount window loans to depository institutions. The Board also established, with the approval of the Treasury Department, the Primary Dealer Credit Facility (PDCF) under our emergency lending authority in section 13(3) of the Federal Reserve Act. Under the PDCF, the Federal Reserve provides loans against good collateral to primary dealers that are critical intermediaries in short-term funding markets. Similar to the large-scale purchases of Treasury securities and agency MBS I mentioned earlier, this facility helps restore normal market functioning.

In addition, under section 13(3) and together with the Treasury Department, we set up the Commercial Paper Funding Facility, or CPFF, and the Money Market Mutual Fund Liquidity Facility, or MMLF. Both of these facilities have equity provided by the Treasury Department to protect the Federal Reserve from losses. Indicators of market functioning in commercial paper and other short-term funding markets improved substantially and rapid outflows from prime and tax-exempt money market funds stopped after the announcement and implementation of these facilities.

In mid-March, offshore U.S. dollar funding markets also came under stress. In response, the Federal Reserve and several other central banks announced the expansion and enhancement of dollar liquidity swap lines. In addition, the Federal Reserve introduced a new temporary repurchase agreement facility for foreign monetary authorities. These actions helped stabilize global U.S. dollar funding markets, and they continue to support the smooth functioning of U.S. Treasury and other financial markets as well as U.S. economic conditions.

As it became clear the pandemic would significantly disrupt economies across the world, markets for longer-term debt also faced strains. The cost of borrowing rose sharply for those issuing corporate bonds, municipal debt, and asset-backed securities (ABS) backed by consumer and small business loans. Effectively, creditworthy households, businesses, and state and local governments were unable to borrow at reasonable prices, which would have further reduced economic activity. In addition, small and medium-sized businesses that traditionally rely on bank lending faced large increases in their funding needs as they struggled with possible closure or substantially curtailed revenues.

To support the longer-term, market-based financing that is critical to economic activity, the Federal Reserve took a number of bold steps. These steps were designed to ensure that credit would flow to borrowers and thus support economic activity. With credit protection provided by the Treasury Department, on March 23 the Board announced that it would support consumer and small business lending by establishing the Term Asset-Backed Securities Loan Facility (TALF). The TALF will lend against ABS backed by newly issued auto loans, credit card loans, and other consumer and small business loans. In turn, these loans will support consumers seeking to obtain these important types of credit.

The Federal Reserve also took action with the Treasury Department under section 13(3) to support the credit needs of large employers through the Primary Market Corporate Credit Facility and the Secondary Market Corporate Credit Facility. These facilities primarily purchase bonds issued by U.S. companies that were investment grade on March 22, 2020. By purchasing these bonds, the Federal Reserve is able to lower the borrowing costs for investment-grade companies and thus facilitate economic activity.

The Federal Reserve is also preparing to launch the Main Street Lending Program, which is designed to provide loans to small and medium-sized businesses that were in good financial standing before the pandemic. Importantly, with these and other facilities that the Federal Reserve has not employed before, public input has been crucial in their development. For example, in response to comments received, we lowered the minimum loan size and raised the maximum loan size across the three lending facilities within the program; in addition, we expanded the size of firms allowed to borrow under the program to companies with up to 15,000 employees. These changes should help the program meet the needs of a wider range of employers that may need bridge financing to support their operations and the economic recovery. We will continue to adjust facilities as we learn more.

To bolster the effectiveness of the Small Business Administration's Paycheck Protection Program (PPP), the Federal Reserve is supplying liquidity to lenders backed by their PPP loans to small businesses. And to help state and local governments better manage cash flow pressures in order to continue to serve households and businesses in their communities, the Federal Reserve, together with the Treasury Department, established the Municipal Liquidity Facility under section 13(3) authority to purchase short-term debt directly from U.S. states, counties, cities, and certain multistate entities. The two corporate credit facilities, the Main Street Lending Program, and the Municipal Liquidity Facility all have equity provided by the Treasury Department to protect the Federal Reserve from losses. The passage of the CARES Act by Congress was critical in enabling the Federal Reserve and the Treasury Department to establish these real economy emergency lending programs that have the capacity to make more than $2.6 trillion in loans.

The tools that the Federal Reserve is using under its 13(3) authority are for times of emergency, such as the ones we have been living through. When economic and financial conditions improve, we will put these tools back in the toolbox.

The final area where we took steps was in bank regulation. The Board made several adjustments, many temporary, to encourage banks to use their positions of strength to support households and businesses. Unlike the 2008 financial crisis, banks entered this period with substantial capital and liquidity buffers and improved risk-management and operational resiliency. As a result, they have been well positioned to cushion the financial shocks we are seeing. In contrast to the 2008 crisis when banks pulled back from lending and amplified the economic shock, in this instance they have greatly expanded loans to customers. Federal Reserve Board Vice Chair for Supervision Randal Quarles spoke to you about these topics last week.

The Federal Reserve has been entrusted with an important mission, and we have taken unprecedented steps in very rapid fashion over the past few months. In doing so, we embrace our responsibility to the American people to be as transparent as possible. We are deeply committed to transparency, and recognize that the need for transparency is heightened when we are called upon to use our emergency powers. This is particularly the case when Congress appropriates taxpayer funds to back lending programs that the Fed administers. In connection with the CARES Act facilities—including the two corporate credit facilities, the Main Street Lending Program, the Municipal Liquidity Facility, and the TALF

—we will be disclosing, on a monthly basis, names and details of participants in each facility; amounts borrowed and interest rate charged; and overall costs, revenues, and fees for each facility.

Thank you, I'd be happy to take your questions.

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