DATA BRIEF

United States Federal Reserve Board Provides Historic Liquidity Response to Combat the Economic Recession of 2020 and the COVID-19 Pandemic

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Summary

The first quarter of the year 2020 was historic for the United States (U.S.) economy in two significant respects. The U.S. economy was concluding a 128-month economic expansion, the longest since 1854. Simultaneously, the U.S. was on the cusp of an explosive viral pandemic, the worst since 1919. These events compelled an equally historic monetary policy response by the United States Federal Reserve Board of Governors (the Fed). Combining massive interest rate cuts and over three trillion dollars of injected liquidity, the Fed demonstrated decisive leadership in combating the twin economic headwinds of recession and pandemic.

A Calm Before A Storm

In late February 2020, Fed Chair Jerome Powell made the following statement regarding the U.S. economy.

> The fundamentals of the U.S. economy remain strong. However, the coronavirus poses evolving risks to economic activity. The Federal Reserve is closely monitoring developments and their implications for the economic outlook. We will use our tools and act as appropriate to support the economy.

Jay Powell released this statement in light of circulating rumors that Severe Acute Respiratory Syndrome Coronavirus 2 (SARS-CoV-2) would function as a significant impediment to U.S. economic growth. Ironically, beginning in February, both the 2020 economic recession and the exponential rise of COVID-19 infections had already commenced within the United States.

From the Federal Reserve's perspective, the forcefulness of its response to the looming COVID-19 pandemic depended upon the degree to which SARS-CoV-2 would affect U.S. economic growth. The Fed decided to employ a "wait and see" approach before deploying the primary monetary policy tool of interest rate reductions. The economic expansion that started in 2010 had demonstrated some signs of stress during the market tumble of late 2018. In December 2018, the Standard & Poors 500 (SP500) stock market index had declined from 2790 on the 4th to 2351 on the 24th, for a 15.7% decline. As a result of this market volatility, the Fed paused its program of quarterly increases in Fed Funds Discount Rate. This pause left the upper bound of the Discount Rate's 25 basis-point (bps) range at 3.00% for the first half of 2019. During the second half of 2019, additional economic exhaustion signals manifested within the Fed-Funds "Repo" market. This dysfunctional market behavior prompted the Fed to institute three monthly 25 bps cuts to bring the upper bound of its Discount Rate to 2.25 percent by October 2019 (see Figure 3). Additionally, the Fed halted the program of reducing its holdings of U.S. Treasury guaranteed securities (see Figure 4).

Notwithstanding these technical adjustments, Jay Powell considered the U.S. economy “strong” as of late February 2020. Subsequently, a series of economic events caused by the exploding COVID-19 pandemic was to force the Fed, within one month, to utilized every emergency monetary tool at its disposal to protect the U.S. from experiencing a catastrophic economic depression.

The Crisis – The Response

The *de-facto* lockdown of the United States economy to arrest the spread of the SARS-CoV-2 began March 16th of 2020. As evidenced by Figure 1, this date was when the Weekly Initial Claims for Unemployment Insurance metric started its meteoric rise from a typical 200,000 to nearly 7 million by the end of March 2020.

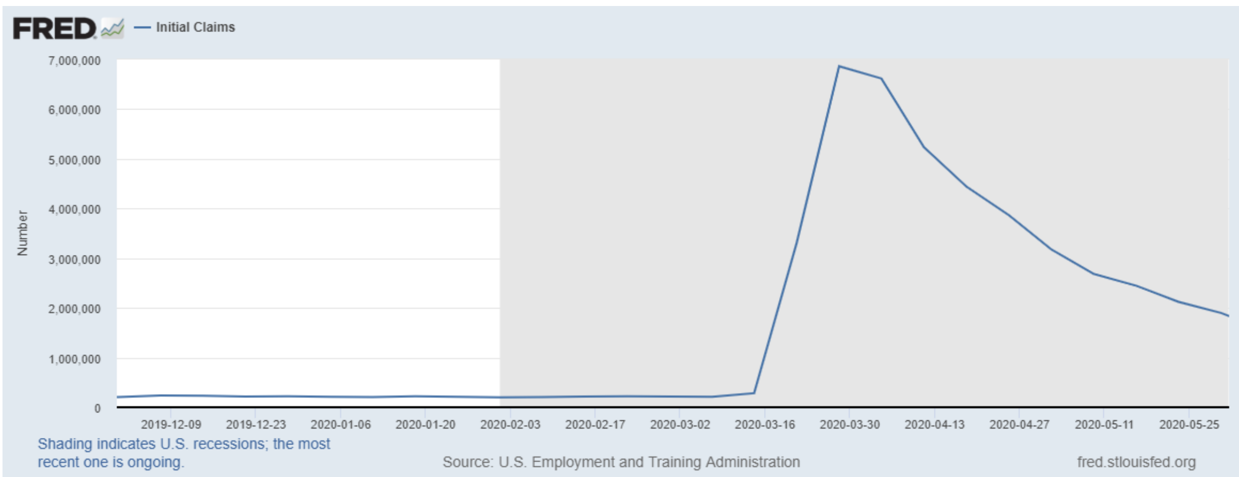

Figure 1 – U.S. Weekly U.S. Initial Claims for Unemployment Insurance

The Nonfarm Payroll Employment metric declined from 152 million in February to 130 million in April. This decline constituted a staggering job loss of 22 million within two months (see Figure 2).

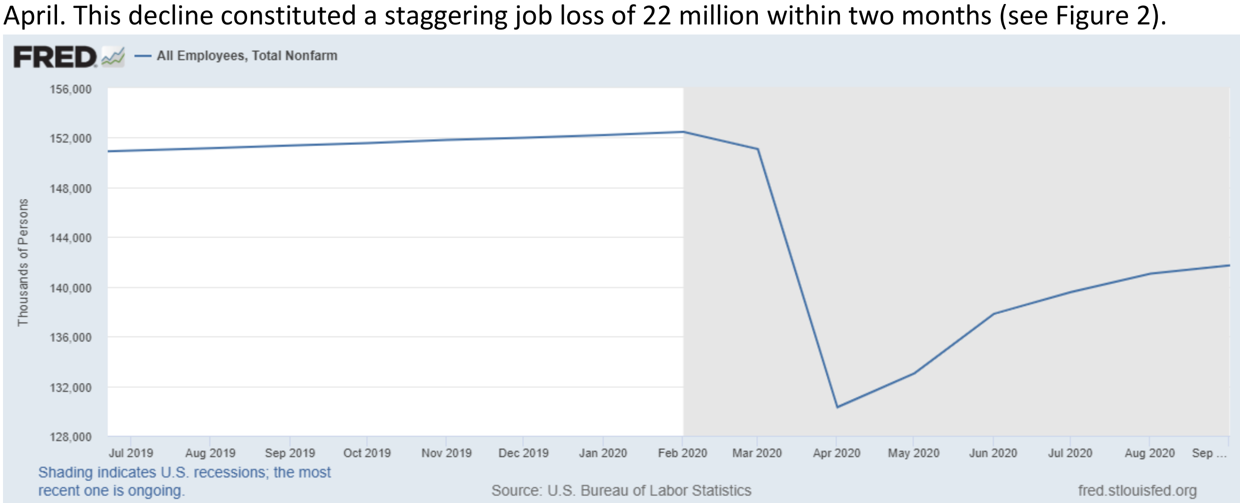

Figure 2 – Monthly Persons Employed in the Nonfarm Sectors of the U.S. Economy

In response to these job loss metrics, the Fed dropped the rate of its primary monetary policy tool to the zero bound (25bps - 0bps) on March 15th (see Figure 3). Additionally, the Fed committed to increasing its balance sheet by $700 billion via purchases of U.S. Treasury guaranteed bonds. The Fed intended these purchases to support the home sales market by suppressing mortgage interest rates.

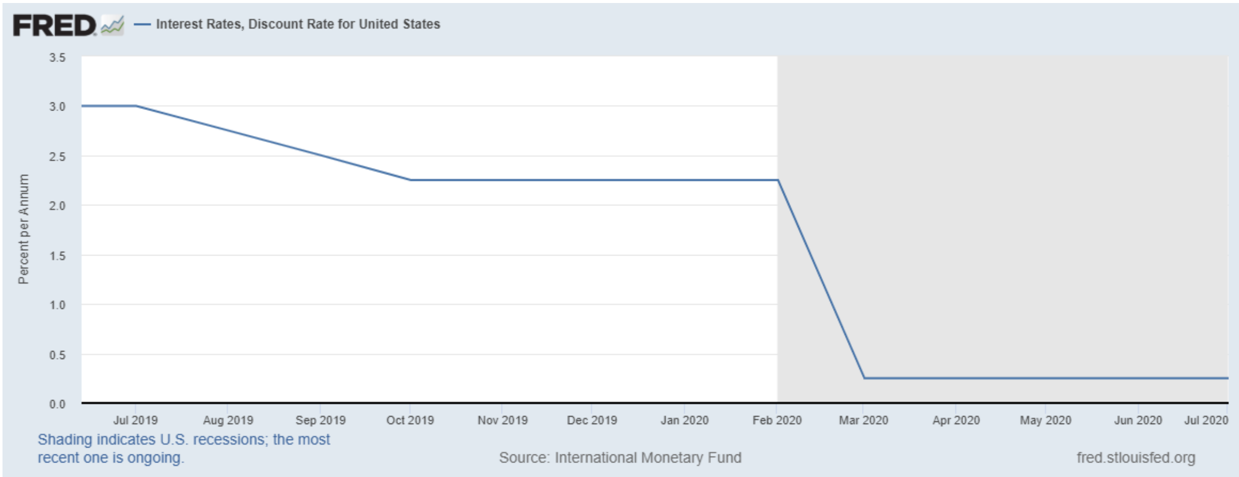

Figure 3 – U.S. Federal Reserve Board Discount Rate Upper Bound (Range = 25bps)

These traditional monetary policy responses proved insufficient to arrest the economic decline caused by the dual headwinds of business cycle recession and virus pandemic. Consequently, the Fed and the U.S. Congress combined forces via the $2.2 trillion CARES act. This act enabled the Fed to provide "*unlimited*" liquidity to the U.S. economy via accounting entities known as *Special Purpose Vehicles*. The Fed increased its balance sheet on the asset side by 72% from $4.1 trillion to $7.2 trillion within three months. This asset purchase increase was the most extensive implementation of Quantitative Easing ever performed by the Fed.

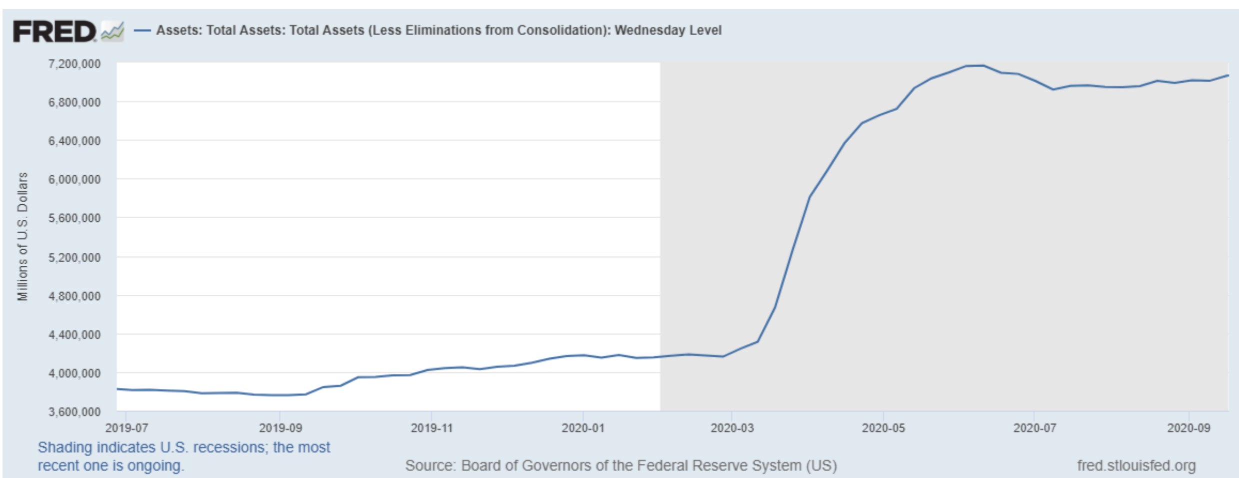

Figure 4 – U.S. Federal Reserve's Total Assets of U.S. Treasuries, Agency Bonds, and CARES Act Authorized Securities

The Federal Reserve's press release "Federal Reserve announces extensive new measures to support the economy" dated March 23rd of 2020, caught the investment community's attention. On this date, the SP500 stock index printed the trough of the 2020 bear market. Ever since this date, the U.S. financial markets have experienced the proverbial 'V' shaped recovery.

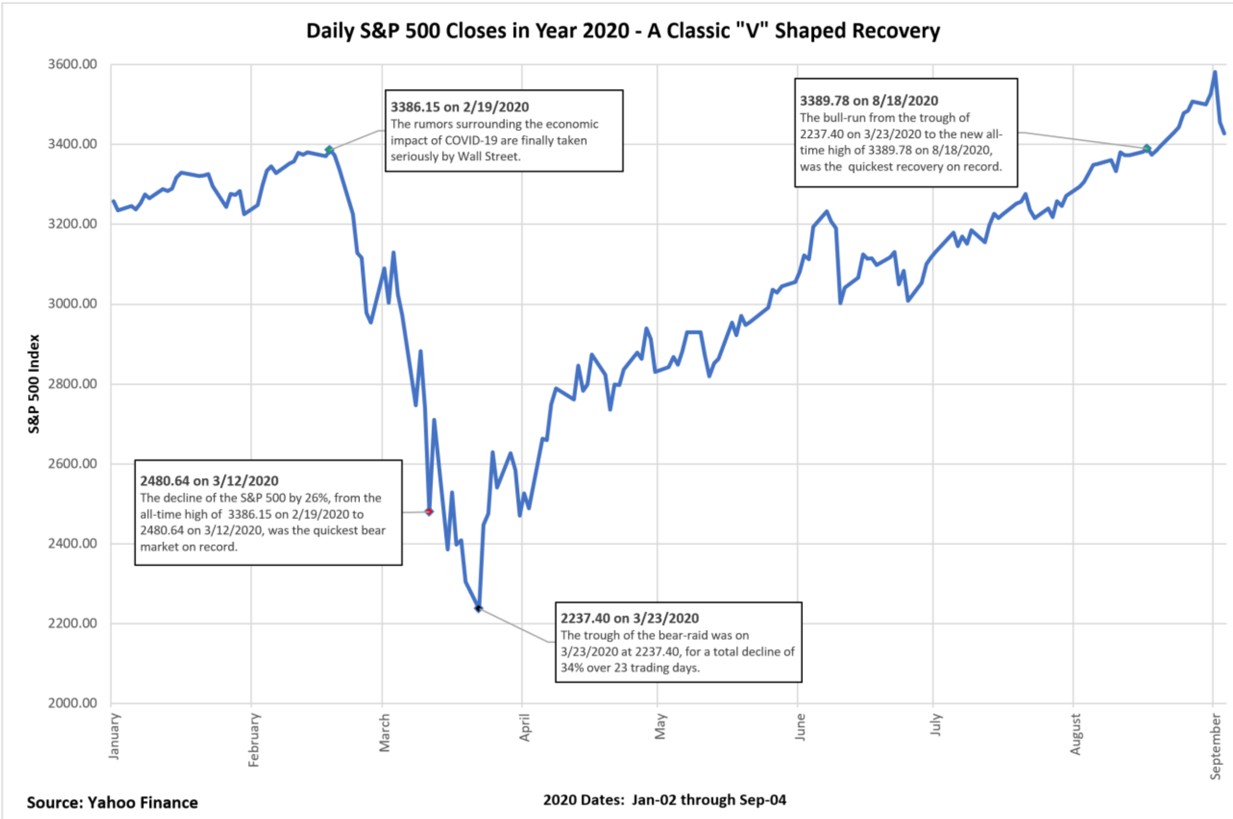

Figure 5 – SP500 Daily Close Chart from JAN through AUG 2020

Mission Accomplished

The stock market, measured by the SP500, had attained a full recovery by September 2020. This recovery was due to the extraordinary liquidity provisions of the Fed and the U.S. Treasury. The picture painted for the U.S. labor market is not nearly as robust. The Weekly Initial Unemployment Insurance Claims metric of 898,000 for October 10^{th} is over 200,000 greater than the highest number printed during the Great Financial Crisis of 2008 (see Figures 6 and 7). Ironically, as of October 7^{TH}, California has yet to process 450,000 Initial Claims. Consequently, the September 2020 Nonfarm Payroll metric of 142 million is 10 million below the February 2020 peak (see Figure 2).

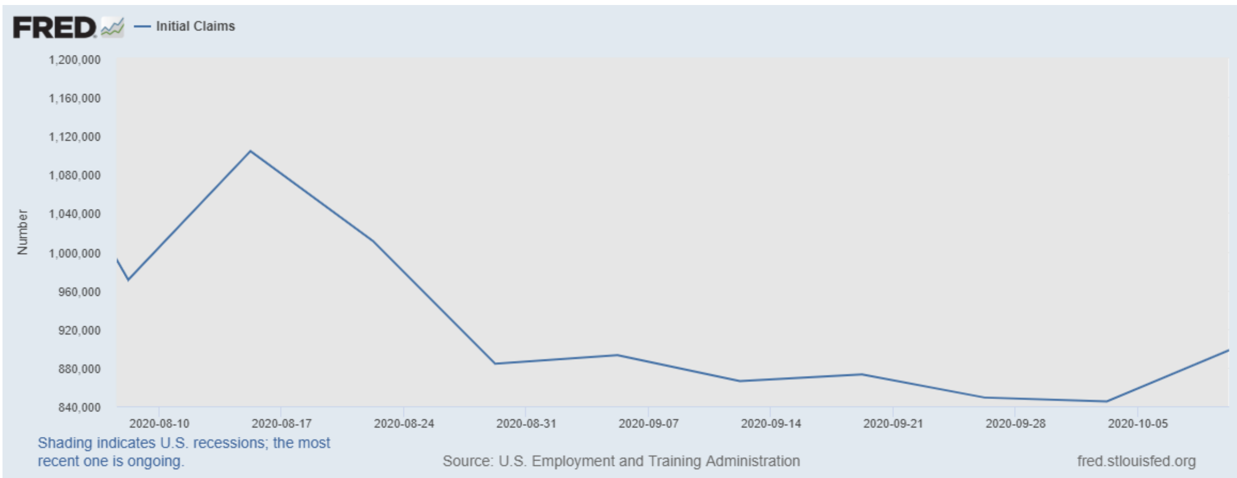

Figure 6 – U.S. Weekly Initial Claims for Unemployment Insurance – From AUG 2020

Figure 7 – U.S. Weekly Initial Claims for Unemployment Insurance – From NOV 2007 – JUL 2009

What are the best indicators that Main Street America has experienced economic recovery? Firstly, the U.S. Labor Participation Rate, currently at 61.4 percent, must return to the pre-recession average of 63 percent. Secondly, the U.S. Weekly Unemployment Initial Claims metric (this time, including California) must decline to its pre-pandemic rate of around 200,000 (see Figure 8). Thirdly, the U.S. Nonfarm Payroll Employment metric must rise to above 150 million. The U.S. economy attaining these three objectives should serve as a strong indicator that a robust economic recovery has occurred on America's Main Street.

Figure 8 – U.S. Monthly Labor Force Participation Rate