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CORPORATES & MARKETS

Economy

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Homage to section 13(3)

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At the end of February, the US stock market peaked before losing one-third of its value in the blink of an eye (it has since made up more than 60% of its losses). Mid-March saw a spate of market dysfunctions, from money market mutual funds to the government bond market. Two months later, the financial meltdown is stemmed. Credit must go to the US central bank, which created (or recreated as in the 2008 financial crisis) emergency lending facilities to provide the desired liquidity. The financial system is in working order. This is a necessary (but not sufficient) condition to repair the devastation in the real economy.

The week's focus

Anyone who has trouble sleeping could find a cure by reading section 13(3) which was added in 1932 to the Federal Reserve Act of 1913. This section is also useful in overcoming financial crises. "*In unusual and exigent circumstances*", it authorises the Fed to take special measures to provide the necessary liquidity to the financial sector and to non-financial agents.

This is the legal basis that the Fed used in 2008, after the collapse of Lehman Brothers, to ease operations for primary dealers, the commercial paper market, money market funds, and securitised consumer loans. These lending facilities have been reactivated. Others have been added with a view to supporting the corporate debt market (PMCCF/SMCCF), banks that lend to small businesses as part of the paycheck protection programme (PPPLF), those that lend to larger companies (MSLP), and last the state and municipal bond market (MLF). To cover the risk of capital losses inherent in these operations, which deviate from its normal activity, the Fed has secured guarantees from the US Treasury Department, drawing criticism from members of Congress. Similar concerns regarding moral hazard were expressed in the 2008 financial crisis, but at the end of the day, the Fed recorded zero losses.

Several of these programmes will not be launched until next month. Those that have already been active for a few weeks involve modest amounts compared with direct purchases of government securities or swaps with foreign central banks (table lhs). This is what the credibility of a central bank is measured by. The guarantee that there is a lender of last resort is often enough to restore operations on the capital markets to normal, without which no economic recovery is possible. Overall, financial conditions have not fully returned to what they were pre-crisis, but most of the disruption has been corrected (chart rhs).

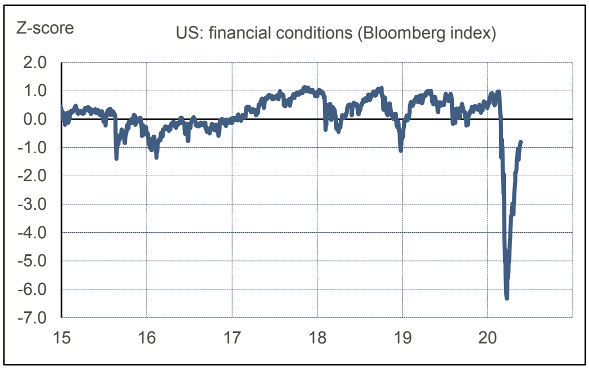
US: Fed's emergency lending programmes

Federal Reserve Emergency Programs (bn $)

Name	Acronym	Announced	Outstanding (on May 20)	Size limit
Commercial Paper Funding Facility*	CPFF	17 March	4	-
Primary Dealer Credit Facility*	PDCF	17 March	8	-
Money Market Mutual Fund Liquidity Facility*	MMLF	19 March	36	-
Primary Market Corporate Credit Facility	PMCCF	23 March	2	750
Secondary Market Corporate Credit Facility	SMCCF	23 March		
Term Asset-Backed Securities Loan Facility*	TALF	23 March	-	100
Payroll Protection Program Lending Facility	PPPLF	6 April	45	-
Main Street Lending Program	MSLP	9 April	-	600
Municipal Liquidity Facility	MLF	9 April	-	500
Fed's assets - other items				
- Securities held outright			*5955*	-
- Central bank liquidity swaps			*446*	-

** emergency facilities already used in the 2008 financial crisis*

US: financial conditions index



Sources: Fed, Bloomberg, ODDO BHF Securities

Economy

- In **April**, all the hard data were dire. Retail sales slumped by 16.3%, extending the trend begun in March (-8.6%). Except for the online purchases category (+8.3% m-o-m), all the other spending categories showed a marked decline. Food product purchases, which had skyrocketed in March (+27% m-o-m) at the start of the lockdown, as households stockpiled over fears of shortages, are returning to normal (-13%). Industrial production fell by 18% after a -5.8% decline in March. The automotive sector is in the worst situation, with production plummeting 80% in two months. Residential construction has also taken a hit. Residential housing starts fell by 30%, and building permits by 21%. All these figures fuel nowcasting models, which are giving jaw-dropping results. According to the latest estimate from the Atlanta Fed, at **19 May**, real GDP could contract by 42% q-o-q annualised in Q2, with two-thirds attributable to household consumption.
- In **May**, the confidence surveys suggest that the slump in activity has probably been stemmed but the start of the catch-up is on a modest scale for the time being. In industry, the indices from the New York Fed and Philadelphia Fed have recovered but are still showing a dire score (around 40pts as an ISM-equivalent, vs 30 at the all-time low in March). In the residential sector, after four straight months of decline, including a 42pt collapse in April, the sharpest ever recorded, the NAHB index has ticked up 7pts. This reflects hopes of a recovery with the easing of the lockdown measures. Unlike the subprime crisis, the current shock is at first glance less dramatic as mortgage debt is not at an unsustainable level. While job losses, pressure on income and rising uncertainty may prompt spending plans to be reviewed, housing demand is as a rule a thought-through decision (leaving aside the subprime bubble, when it clearly was not). After 2007, households were forced to deleverage for several years. There is not the same pressure this time. On the contrary, the decline in borrowing rates is a factor supporting housing demand, at least for households with high credit scores. Moreover, if home working continues to be developed, it could encourage demand for housing on a larger scale, with better facilities and further from the city centre. According to the preliminary data, the PMI indices stand at 39.8 (+3.7pt) in manufacturing and 36.9 (+10.2pts) in services.

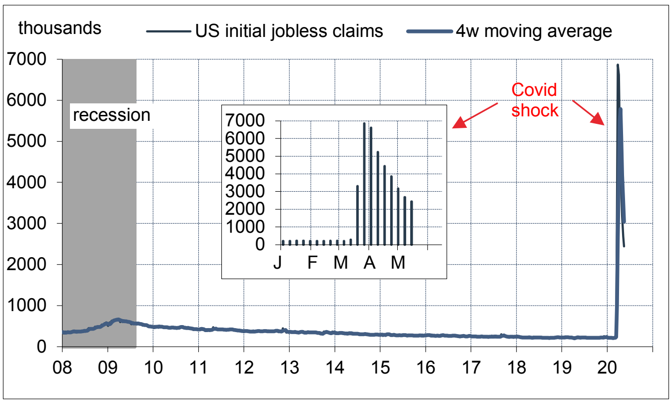
Monetary and fiscal policy

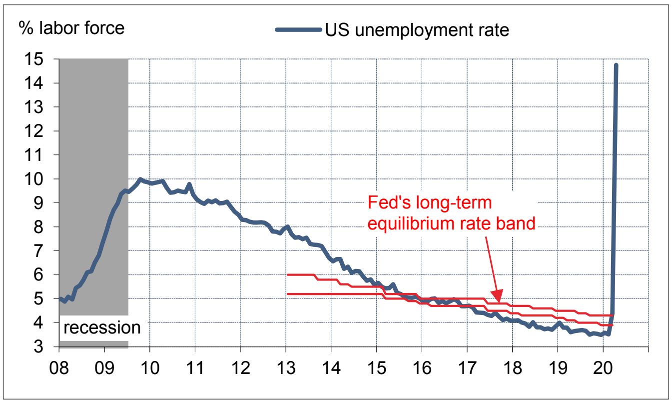
- The Fed Chairman gave a long televised interview with CBS on **17 May**. This was a tricky exercise in communication because he needed to strike the right balance between the desire to support morale with messages of hope and the harsh economic reality (unemployment about to hit the 25% mark and real GDP collapsing by 30-40% on an annualised basis in Q2). Jerome Powell said that Fed could expand its intervention further, if needed, to ensure the smooth functioning of the financial system, but once again, he ruled out the use of negative interest rates. In his view, monetary policy has therefore not reached its limits. This was the same message he repeated when speaking before the Senate on **20 May** as he itemised a long list of emergency measures created or reactivated during this crisis (see p.1, as well as *Focus-US* of 24 April: "The Fed, the plumber of last resort"). For fiscal policy, which is part of Congress's remit, not the Fed's, Mr Powell was more measured but he did say that it would be worth extending the payroll protection measures for those who had lost their jobs.

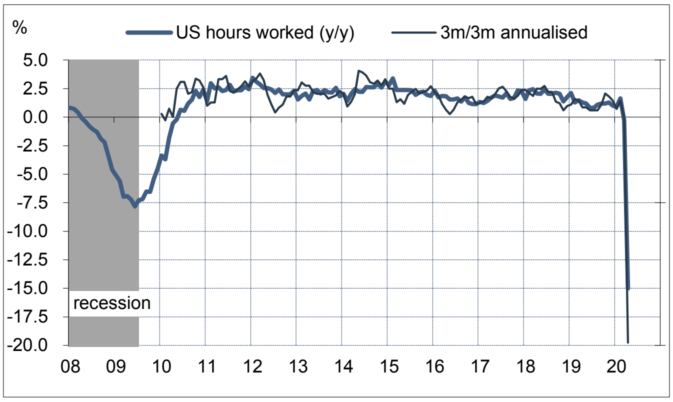
The week ahead

- Several statistics will provide details about the consumer's situation. Personal spending for **April** (on **29 May**) should fall even more than in March (-7.5% m-o-m). With the shock to income being lower, the savings rate should continue to rise. It had already jumped by over 5 points to 13.1% of disposable income the previous month. The Conference Board consumer survey for **May** (on **May 26**) will be a useful indicator of how households see labour market conditions after the devastation of April. Weekly jobless claims (on **May 28**) have, granted, passed their peak of almost 7 million at the end of March, but the decline since then has been on the slow side. In the week of **16 May**, they came to 2.4 million. The Beige Book's survey (**27 May**) based on the information at mid-May should once again depict a sharp restriction in activity even though lockdown measures have started to be eased in many states.

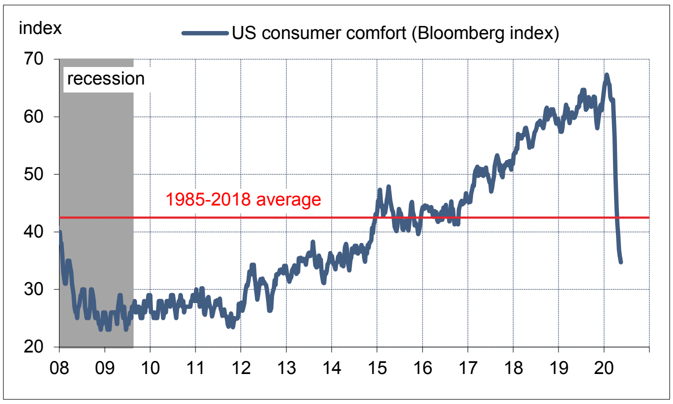
Appendix 1 - Labour market

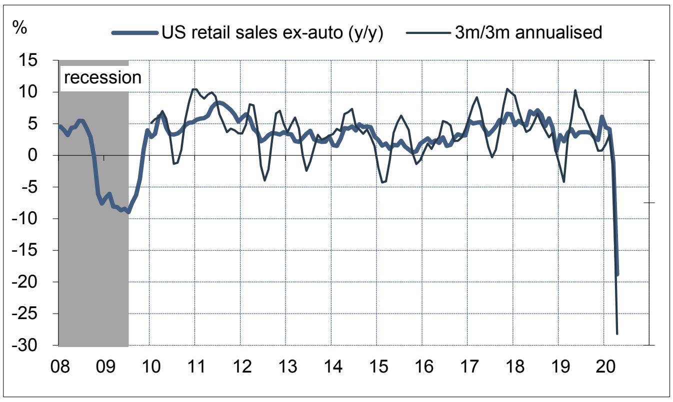


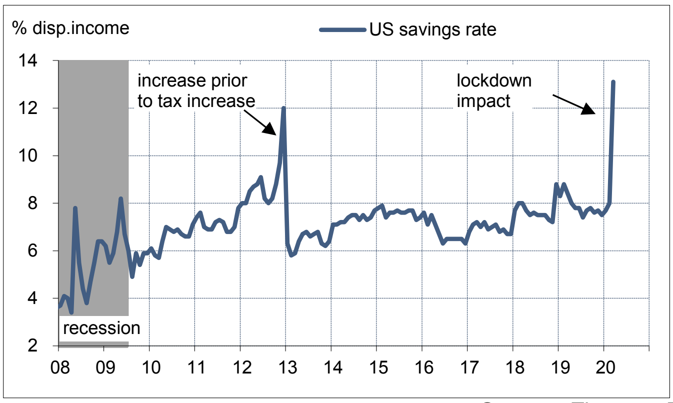


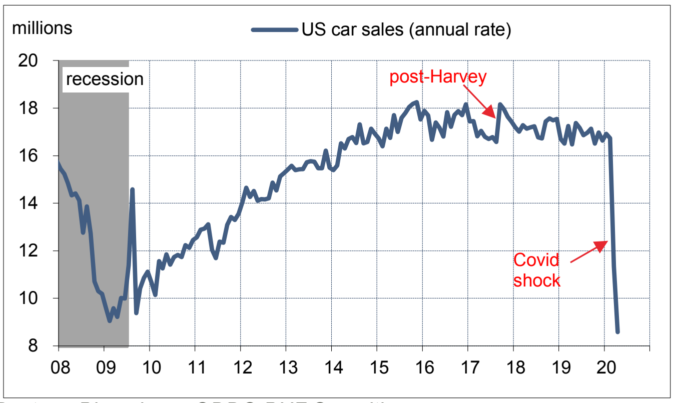


Appendix 2 - Consumer



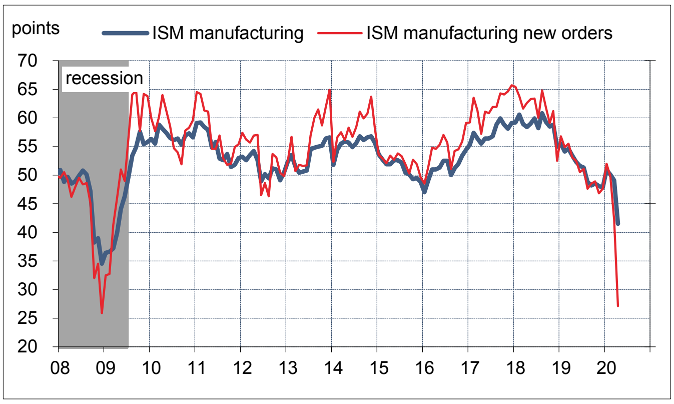


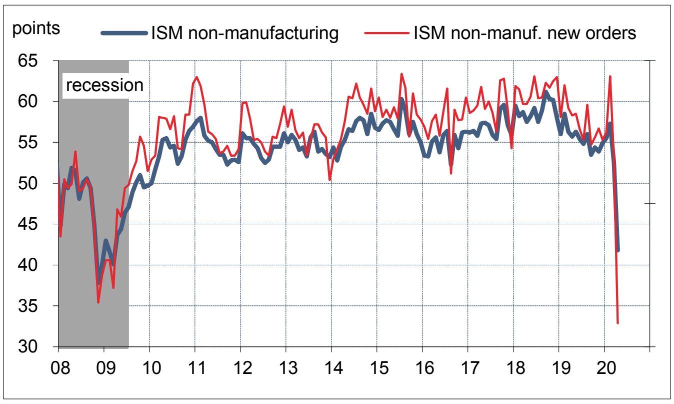


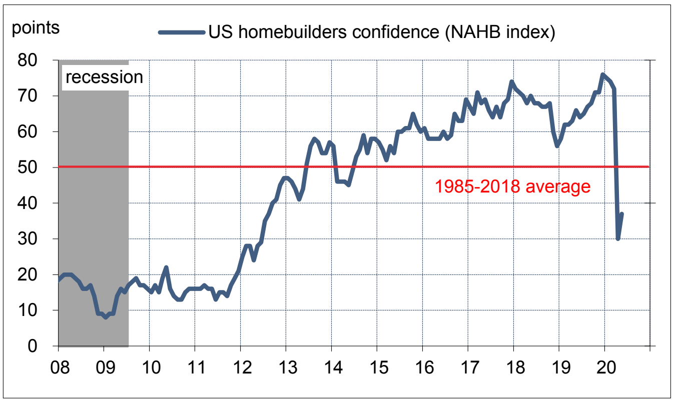


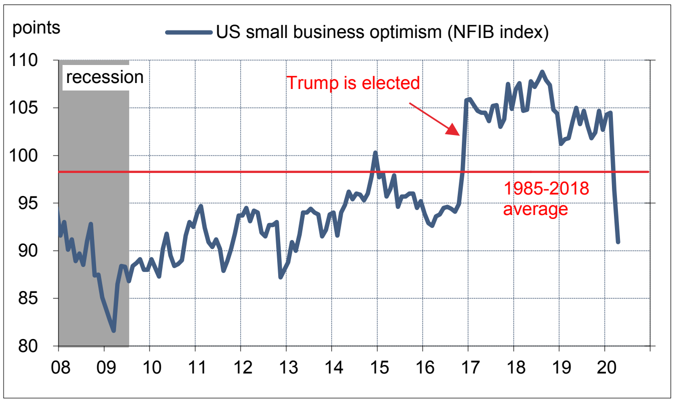
Sources: Thomson Reuters, Bloomberg, ODDO BHF Securities

Appendix 3 - Business climate

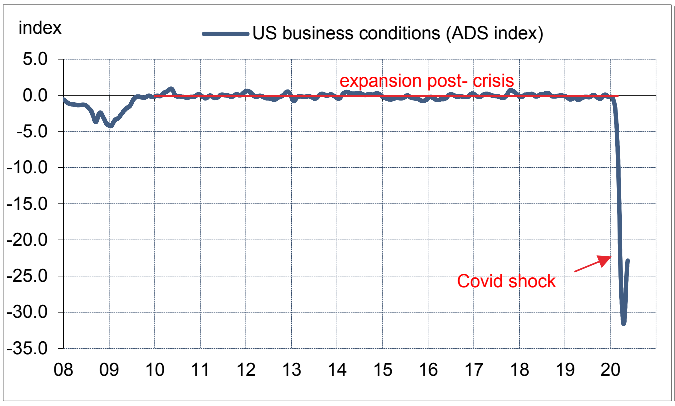


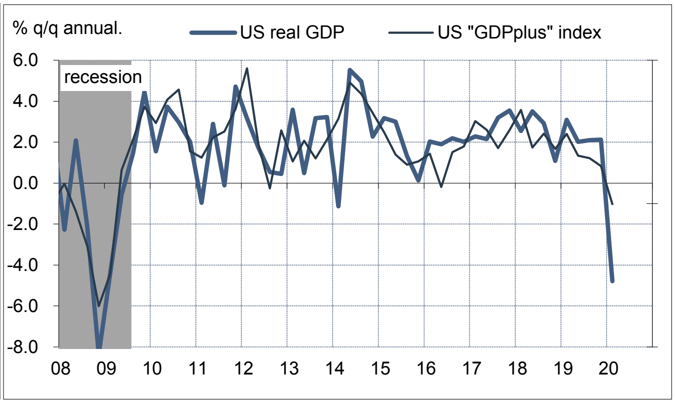


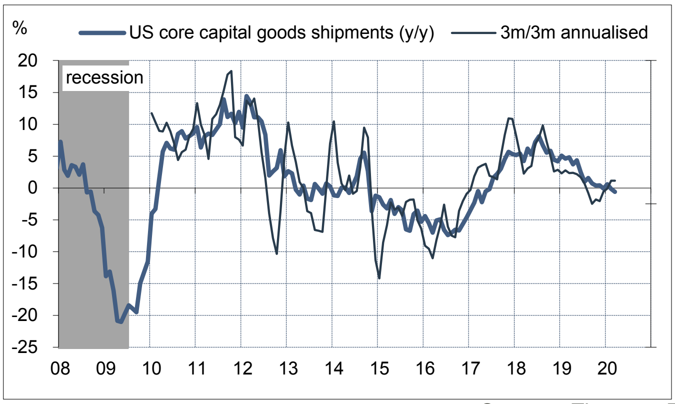


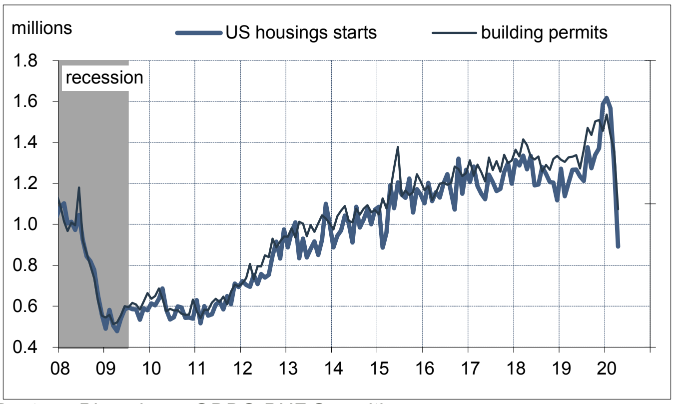


Appendix 4 - Conditions of economic activity



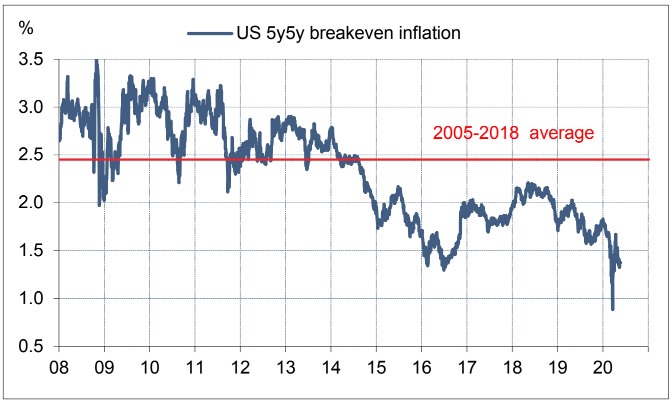


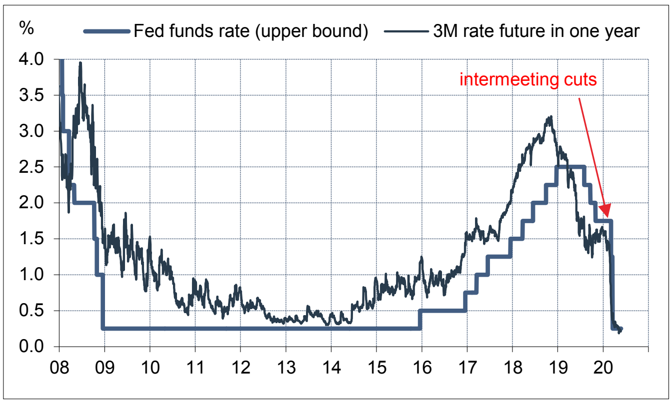


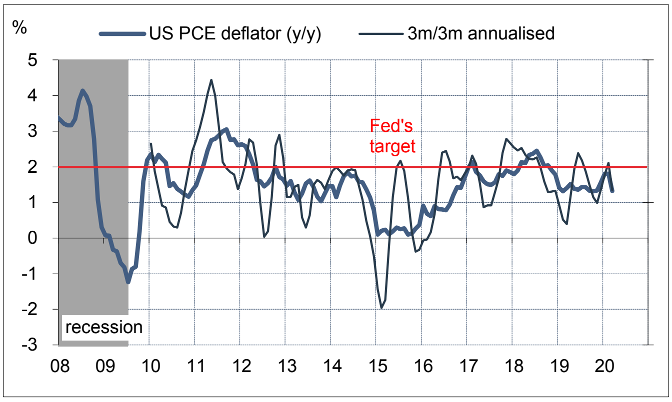


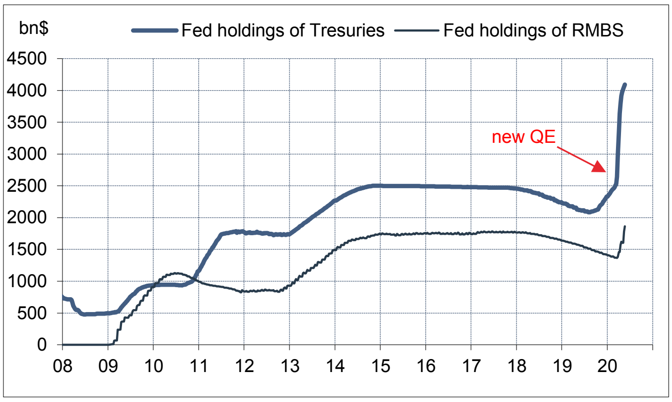
Sources: Thomson Reuters, Bloomberg, ODDO BHF Securities

Appendix 5 - Inflation and monetary policy

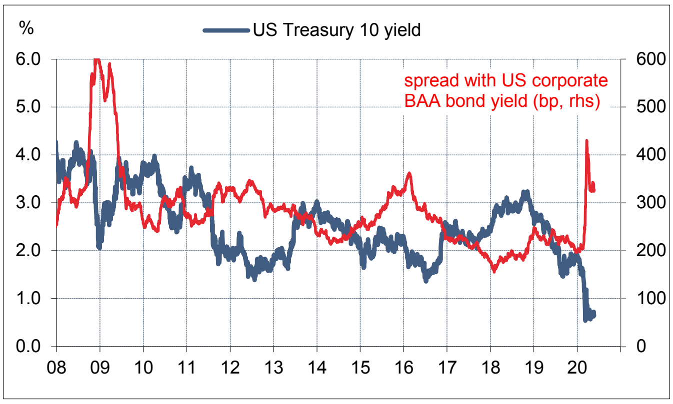


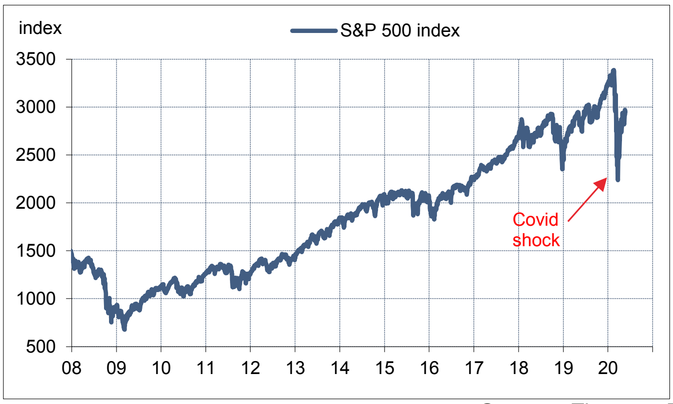


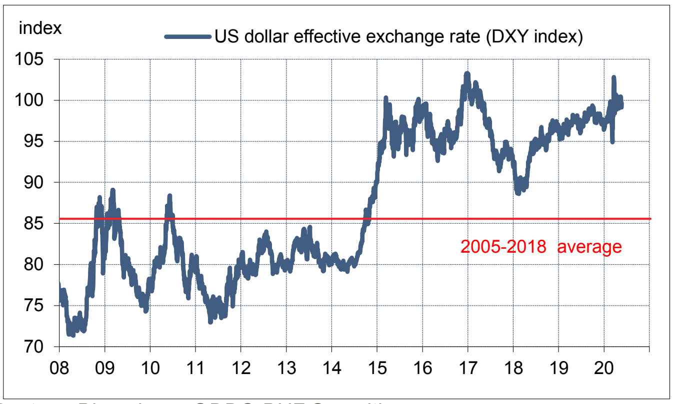




Appendix 6 - Financial markets







Sources: Thomson Reuters, Bloomberg, ODDO BHF Securities

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