Given the global pandemic and the imminent economic crisis, it is important to understand what is happening in our economy and what the consequences will be. The world is looking for a vaccine for the pandemic; however COVID-19 has affected not only the health of people but the health of the economy, and both need to be cured. What will be the vaccine for our economy? The Federal Reserve is introducing what they consider to be stabilizing measures. However, those measures can have negative effects on our economy and the financial system in the future, and it is crucial for us to understand how and why.

As professionals, we can use the second HPT standard and take a systemic view to understand how dynamics in the global economy impact society, the marketplace, the workplace, work, and the workforce, so that we stay relevant.

The response to the current situation should not be to ignore it or to hope that it will resolve on its own. Understanding, creating awareness, and uniting is what will save our economy and freedom.

The Federal Reserve and the Department of Treasury

To understand the current situation and its implications, we need to understand the structure and function of the Federal Reserve and the U.S Department of Treasury. The Federal Reserve (the Fed) is the central bank of the United States. The Federal Reserve was established to serve the public interest by promoting the effective operation of the U.S. economy and the stability of the U.S. financial system. The Federal Reserve's functions include supervision of the nation's monetary policy and oversight of the financial system and the soundness of individual financial institutions. The three key Federal Reserve entities are the Federal Reserve Board of Governors (Board of Governors), the 12 Federal Reserve Banks, and the Federal Open Market Committee (FOMC).

According to the Federal Reserve (2020), “The Board of Governors is the governing body of the Federal Reserve System. It is run by seven members, or ‘governors,’ who are nominated by the President of the United States and confirmed in their positions by the U.S. Senate” (FRB, 2020). Each member of the board is appointed for a 14-year term. All members of the board serve on the FOMC, which is responsible for monetary policy. The FOMC makes decisions regarding the federal funds rate (interest rate), the size of the Federal Reserve’s asset holdings, and communication with the public regarding the future course of the monetary policy, all of which are discussed further along in this article.

The U.S. Treasury is a department of the U.S. government. The Department is responsible for advising the President on economic and financial issues, encouraging sustainable economic growth, and fostering improved governance in financial institutions. The main functions of the Treasury include collecting taxes, producing the coin and currency, managing federal government accounts and the public debt, enforcing federal finance and tax laws, and advising on domestic and international trade and tax policy. The Treasury is governed by the Secretary of the Treasury, who is nominated by the President and confirmed by the U.S. Senate. Given an understanding of the Federal Reserve and the Department of Treasury, we can better comprehend the decisions made by both parties regarding the recession and how those decisions will impact consumer lives and the U.S. economy (see Table 1).

Pandemic Measures by the Federal Reserve and How They Will Impact Consumers

On March 15, 2020, the Federal Reserve announced the lowest interest-rate cut since the financial crisis of 2008 to nearly 0% and a purchase of $700 billion in Treasury and mortgage bonds. But what does that mean to us as consumers? The interest rate is a federal-funds target rate.
TABLE 1

ROLES AND RESPONSIBILITIES OF THE FEDERAL RESERVE BANK AND THE TREASURY DEPARTMENT

Federal Reserve Bank

Governance
- The Board of Governors
- Seven-member board
- Appointed for 14 years
- Nominated by the President of the United States
- Confirmed by the U.S. Senate

Functions
- Supervision of the nation’s monetary policy
- Oversight of the stability of the financial system
- Regulation and supervision of financial institutions
- Maintenance of an efficient payment and settlement system
- Supervision of consumer protection and community development

Treasury Department

Governance
- The Secretary of the Treasury
- Member of the Cabinet and the National Security Council
- Nominated by the President of the United States
- Confirmed by the U.S. Senate

Functions
- Collection of taxes
- Production of coin and currency
- Enforcement of the federal finance and tax laws
- Advising on domestic and international trade and tax policy
- Management of U.S. Government accounts and the public debt

It is the interest rate that banks charge other banks for lending them excess cash from their reserve balances. The Federal Reserve uses the interest rate as a tool to achieve price stability and sustainable economic growth. By changing the interest rate, the Fed is influencing the money supply available to the banks and, as a consequence, to the consumers. The Fed lowers interest rates to stimulate economic growth. Lower financing costs encourage borrowing and investing. However, when rates are too low, they can promote excessive growth and inflation. In other words, the lower interest rate makes it cheaper for banks to borrow money from other banks and to lend more money to consumers. By lending more money to consumers, the Fed hopes to increase consumer spending which, in turn, should stabilize the economy.

However, in times of economic distress, consumers typically hoard resources and concentrate on saving rather than spending. The Fed implemented classic moves from the crisis playbook, which are lowering the interest rate and purchasing Treasury bonds and mortgage-backed securities. These strategies worked in a previous crisis but are not working now. The central bank did not consider that for the economy to operate, businesses need to function as usual and consumers need to be spending money. With the lockdown due to the pandemic, the traditional actions are not working, and the emergency rate cut by the Fed is not providing the necessary relief to the economy. In response to that, the Fed announced $1 trillion a day in repurchase agreements and unlimited quantitative easing. According to Jim Bianco (2020), the President of Bianco Research, “At this rate, the Fed will own two-thirds of the Treasury market in a year.” What does that mean? This move is called debt monetizing. The central bank monetizes the debt by purchasing U.S. Treasury bills, bonds, and notes, and providing liquidity to the banks, which promotes lending and consumer spending.

On March 23, after employing the classic tools used during the previous decade, the Fed announced the establishment of additional loan programs:

- PMCCF (primary market corporate credit facility) – buying corporate bonds from the issuer
- SMCCF (secondary market corporate credit facility) – buying corporate bonds and bond ETFs in the secondary market
- TALF (term asset-backed securities loan facility) – funding backstop for asset-backed securities
- CPFF (commercial paper funding facility) – buying commercial paper from the issuer

The central bank declares that these programs are supposed to help companies on the brink of insolvency to access financing by purchasing corporate and consumer debt. According to Jim Bianco, “The Fed isn’t allowed to do any of this. The central bank is only allowed to purchase or lend against securities that have a government guarantee. This includes Treasury securities, agency mortgage-backed securities, and the debt issued by Fannie Mae and Freddie Mac.”

Nationalization of the Financial Market

So how does the Fed do this? The Fed has established a special-purpose vehicle (SPV) for each acronym program to conduct operations. The U.S. Treasury will make an equity investment of $10 billion in each SPV and be in a “first-loss” position. This means that the Treasury, not the Fed, is buying all these securities and backstopping of loans, and the Fed is acting as a banker and providing financing. This move essentially merges the Fed and the Treasury into one organization.

This is called the nationalization of the financial market. This should be a cause of concern. The nationalization means transforming privately owned assets into public assets by bringing them under the ownership of the national government. If the acronym programs are abused, they might force the markets to appear overvalued. This will
remove the necessary market signals that capital markets offer. As a result, investors will be deprived of the accurate information they need to efficiently allocate capital. This will create a breeding ground for market bubbles. The examples of nationalization are the U.S. federal funds market and the government bond market in Japan.

Crisis Playbook Revision

Today’s situation proves that the Fed’s crisis playbook requires a revision. It may have worked in the past, but this is the health crisis, and the strategies that worked in the crises caused by economic or financial factors are not effective. As the government seems unprepared to handle the number of people and businesses affected by the crisis, the Federal Reserve does not have measures in place to respond to a crisis triggered by the pandemic.

This crisis will start to resolve when the pandemic is under control, a vaccine has been created, and businesses go back to functioning as usual. Currently, the Fed is doing all it can to bring liquidity to the market, but what needs to be done is a revision of the crisis playbook.

Possible Implications of the Federal Reserve’s Decisions

The implications of the Fed’s decisions will be known only in the future. However, there are several areas where issues can arise. The nationalization of the financial market will deprive investors of market signals, and the malinvestment can be pervasive. The Fed’s policies of issuing massive amounts of debt could promote further overcapacity and poor capital allocation. The government can always “print” more money, but if the money is not supported by economic growth it creates inflation. The result is the collapse of productivity growth, a decrease in wages, an increase in the cost of living, and reduction of the purchasing power of currency. Next, the misuse of the acronym programs may result some companies being favored over others, creating an imbalance in the market.

The accumulation of economic imbalances will eventually explode. Essentially, the financial crisis is not being resolved, it is merely being passed on to the future. The government is issuing more debt, but the people are the ones who will be paying for it. As Daniel Lacalle (2020), PhD in Economics, said, “It is a clever Machiavellian system to end free markets and disproportionately benefit governments through the most unfair of competitions: having unlimited access to money and credit and none of the risks. And passing the bill to everyone else” (Lacalle, 2020).

Vaccine for Our Economy

While governments around the world are striving to find a vaccine for COVID-19, maybe it is up to citizens to be the vaccine for the economy. The goal is to understand what the government is doing and how people will be affected in the future. The response to the current situation should not be to ignore it or to hope that it will resolve on its own. Understanding, creating awareness, and uniting is what will save our economy and our freedom. Looking into the future, the Central Bank needs to enact a sustainable monetary policy in a zero-interest-rate environment and perform structural reform of the financial system and the monetary regime. Let’s come out of this pandemic more united, aware of the world around us, and let’s become better people and better citizens.

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