Federal Financial Analytics, Inc.

What the Fed Should, Can Do ASAP to Reduce COVID-19 Macro Risk - Emergency Liquidity for Hard-Hit Households, Small Business

STATEMENT from Karen Petrou, Managing Partner, Federal Financial Analytics, Inc.

There is one way the Federal Reserve could quickly, safely, and meaningfully reduce U.S. macroeconomic strain due to the novel corona virus: use its emergency-liquidity authority to backstops banks providing forbearance to hard-hit households and small businesses. Here's how.

As detailed on Friday, hundreds of millions of Americans will be unable to meet their financial obligations if the COVID-19 crisis curtails employment. The Monday inter-agency forbearance statement is helpful, but provides little meaningful guidance and no relief from the capital and liquidity cost of even short-term forbearance. Express regulatory relief also poses risks that banks will be still more exposed to risk if short-term liquidity problems turn into a solvency crisis. As a result, banks are likely only to provide limited borrower relief, exposing families to economic hardship and leaving them at still greater risk of predatory lending.

Solution: The FRB's 13(3) emergency-liquidity authority can be triggered with the consent of the Secretary of the Treasury in situations just like this. The Fed could provide funding to banks through 13(3) specifying for example that liquidity will cover three months of credit-card payments up to a certain sum (e.g., $2,000 per borrower) for customers that can demonstrate short-term unemployment, lack of sick leave, imposition of a quarantine for the borrower or immediate family member, or in similar circumstances. Small businesses meeting simple eligibility requirements could also receive near-term forbearance on existing or even additional extensions of credit to ensure rental or similar payments.

The Fed could offer this 13(3) liquidity also to nonbanks, but it would presumably wish to do so only upon demonstration of sufficient collateral. Controls would also need to ensure that nonbanks do not use 13(3) funds to shield themselves instead of borrowers from short-term liquidity strain.

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