The Daily Dish

Never Take a Knife to a Gunfight

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Eakinomics: Never Take a Knife to a Gunfight

Yesterday at 8:00 am the Federal Reserve unloaded its arsenal, announcing an open-ended, unlimited buying spree. As the Fed put it, "The Federal Open Market Committee (FOMC) will purchase Treasury securities and agency mortgage-backed securities *in the amounts needed* to support smooth market functioning and effective transmission of monetary policy to broader financial conditions and the economy" (emphasis added).

But that is not all. As detailed in a new report by AAF's Thomas Wade, the Fed expanded the powers of two existing programs and created two new facilities to extend credit to large employers via the purchase of corporate debt. The Fed also revived an emergency lending vehicle last used in the 2007-08 financial crisis to support small businesses and consumers by encouraging investors to snap up securitized student debt, auto debt, and credit-card debt. And efforts are only beginning, as the Fed noted: "In addition to the steps above, the Federal Reserve expects to announce soon the establishment of a Main Street Business Lending Program to support lending to eligible small-and-medium sized businesses, complementing efforts by the SBA."

The upshot is summarized in the chart below, stolen from Wade's piece.

Glossary and timeline of Fed emergency lending facilities

Date	*Facility*	*Acronym*
March 17	Commercial Paper Funding Facility	CPFF
	Primary Dealer Credit Facility	PDCF
March 18	Money Market Mutual Fund Liquidity Facility	MMLF
March 23	Primary Market Corporate Credit Facility	PMCCF
	Secondary Market Corporate Credit Facility	CMCCF
	Term Asset-Backed Securities Loan Facility	TALF
TBA	Main Street Business Lending Program	

Now for the bad news: It won't work. In the immediate aftermath of the announcement, the Dow Jones Industrial Average rallied by over 1,000 points. But within short order, equity markets were heading south again.

It's not the Fed's fault; it is simply dealing with the symptoms and not the cause. When the customers disappeared, businesses had no revenue, a phenomenon that has cascaded through the economy. In similar fashion, when their jobs disappeared, workers had no income. In both cases, people started selling everything they could lay their fingers on to raise cash and hang on. The mass sell-off has buffeted financial markets, and the Fed has done a sterling job of minimizing the turbulence, but the underlying problem remains. If something is not done to address the underlying decline in the Main Street economy, the financial markets will ultimately fall apart.

The good news: Congress can do something about this, but as I write on Monday afternoon it has thus far been unable to get out of its own way and get the job done. The Fed was laying the groundwork for passage of some form of emergency loan program, both for small businesses (about $300 billion in the latest Senate draft) and large business (about $500 billion). The Fed is opening up facilities that can purchase these loans, thereby ensuring that the cash positions of both the borrower and the lender are supported.

So, with Congress's help, the Fed action can be both dramatic and effective. In its absence, the Fed is simply outgunned.