The Daily Dish

The Treasury, the Fed, and the Fate of Temporary Policies

DOUGLAS HOLTZ-EAKIN | NOVEMBER 23, 2020

Eakinomics: The Treasury, the Fed, and the Fate of Temporary Policies

Thursday, Treasury Secretary Steven Mnuchin sent Federal Reserve (Fed) Board Chairman Jerome Powell a letter announcing his intention to not extend the temporary lending facilities funded by the Treasury under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, but located at the Fed. Thus, the Primary Market Corporate Credit Facility (PMCCF), the Secondary Market Corporate Credit Facility (SMCCF), the Municipal Liquidity Facility (MLF), the Main Street Lending Program (MSLP), and the Term Asset-Backed Securities Loan Facility (TALF) will expire on December 31, 2020. I confess that when I first heard the news it came across as a spiteful move by a lame duck administration. But I'm now not so sure about that.

To begin, these facilities are all destined to go away, the only question is when. Financial markets participants are always preaching about the evils of uncertainty; expiration on December 31 has a lot more policy clarity than an extension to a future of unknown duration.

Second, it is hard to defend the efficacy of these efforts on the whole. The MSLP and MLF are unmitigated failures. Nobody disputes that. The remainder have seen relatively modest activity, at best. If these are not attractive places to do business, why not do away with them? The counterargument is that the mere announcement of these facilities gave markets confidence and lowered risk spreads and, thus, borrowing costs.

But, third, those impacts occurred when markets were roiled by the COVID-19 selloff. As the Mnuchin letter makes clear, market conditions are much better now. Volumes have returned to pre-COVID levels and spreads are nearly back to their previous levels. It is far from obvious that markets need even the promise of the existence of these facilities. Of course, if spreads widen on the announcement that the facilities will lapse, Mnuchin has time to reverse course. The data can decide this one.

Fourth, these facilities are distortionary. They target specific asset classes and favor them over others. Letting them lapse returns the allocation of capital to private incentives.

Next, it is not like the Treasury has turned its back on financial markets. Mnuchin's letter noted: "In an abundance of caution, however, I am requesting that the Board of Governors of the Federal Reserve approve an extension of the two facilities that used Core ESF funding (CPFF and MMLF) and the two facilities that did not require Treasury funding (PDCF and Paycheck Protection Program Liquidity Facility) for a period of an additional 90 days." Instead, only those facilities that use CARES funding are lapsing; Mnuchin expresses the desire that the funds be reallocated to other rescue purposes. Since he really cannot do anything about that, however, it should not have figured deeply in his decision. ?Nor indeed does this mean the Fed is doing nothing, continuing its robust asset purchase program outside of these emergency facilities — to significantly better effect.

Finally, none of this is irreversible. The Fed can request that the Treasury approve so-called 13(3) facilities anytime, and Treasury has enough funds in the Exchange Stabilization Fund to get started in a new crisis.

All this said, it did give me pause when the Fed took an unusual public stance against the move. *The Washington Post* quotes the Fed as saying: “The Federal Reserve would prefer that the full suite of emergency facilities established during the coronavirus pandemic continue to serve their important role as a backstop for our still-strained and vulnerable economy.” It is unusual to see the Fed and Treasury squabble so publicly.

In the end, this strikes me as a tough policy call, about which reasonable parties can simply disagree.