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# Research Briefing | US

## Treasury & Fed play Battleship in tainted Covid waters


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- **Treasury Secretary Mnuchin's decision to allow five of the Fed's nine emergency facilities to expire at year end represents a risk for the economy.**
- **While the backstop measures have been little used so far, the deteriorating health and economic backdrop could shine a bright light on the Fed's diminished recession-fighting arsenal and prompt an adverse market reaction.**

Mnuchin announced that he would allow the primary and secondary market corporate credit facilities, the Municipal Liquidity Facility, the Main Street Lending Program and the Term Asset-Backed Securities Loan Facility to expire on December 31. He also requested the Fed return unused funds from the $454bn envelope – authorized via the CARES Act – used to backstop the emergency lending programs. While the Fed could use its Core Exchange Stabilization Fund to reestablish these facilities, we estimate its lending firepower would be ten times smaller.

While we believe the Fed will abide by the Treasury decision, it stated it would "prefer that the full suite of emergency facilities […] continue to serve their important role as a backstop for our still-strained and vulnerable economy," highlighting a rare and poorly-timed public quarrel between the two institutions.

The emergency lending facilities have been little-used, but their existence has been key in ensuring a credible safeguard against financial market stress. With the Covid-19 crisis worsening and activity slowing in the absence of fiscal aid, the decision to curtail the Fed's firepower could unsettle markets and exacerbate economic stress.

The risk is multifold including rising yields for struggling companies, constrained access to credit for small and medium-sized businesses and exacerbated financial difficulties for budget-constrained municipalities.

Mnuchin hopes was that Congress will consider reallocating unused CARES funds for new stimulus measures without incurring a larger budget deficit – roughly $580bn of appropriated, but leftover funds from the PPP program and the Fed's emergency lending facilities backstop.

However, with partisanship in Congress preventing the delivery of urgently needed fiscal aid, and low rates negating any imminent debt servicing concern, Mnuchin's justification appears poorly grounded. And, it may backfire by leaving the Fed as the only adult in the room to address a concerning economic situation in the final stages of 2020.

Overall, this tilts the balance towards additional monetary policy stimulus via an increase the duration of Fed asset purchases, stronger forward guidance and perhaps an increase in the pace of QE.

If financial markets perceive the Fed's position as having been substantially weakened, then weaker economic activity, and the prospect of expiring eviction and foreclosure moratoria, student loan repayment relief ending and 12 million unemployed individuals losing their benefits at year end could lead to tightening financial conditions.


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