Federal Reserve Promises a Trillion-Plus in Short Term Loans to Banks.

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In an attempt to quell market and banking fears about coronavirus-related downturns, the New York branch of the Federal Reserve announced new plans today:

> For the monthly period beginning March 13, 2020 and continuing through April 13, 2020, the Desk will conduct purchases across a range of maturities….
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> Today, March 12, 2020, the Desk will offer $500 billion in a three-month repo operation at 1:30 pm ET that will settle on March 13, 2020. Tomorrow, the Desk will further offer $500 billion in a three-month repo operation and $500 billion in a one-month repo operation for same day settlement. Three-month and one-month repo operations for $500 billion will be offered on a weekly basis for the remainder of the monthly schedule. The Desk will continue to offer at least $175 billion in daily overnight repo operations and at least $45 billion in two-week term repo operations twice per week over this period.

These "repo operations" mean that the Federal Reserve will be providing liquidity in the form of cash in exchange for securities, which the entities getting the money are supposed to purchase back later.

For the past few months, the Fed has been on a $60 billion plan of securities purchases, but that was mostly just short-term Treasury bills. It is expanding those schemes, per its statement today, "to distribute reserve management purchases across eleven sectors, including nominal coupons, bills, Treasury Inflation-Protected Securities, and Floating Rate Notes."

As the Wall Street Journal tallies, today's "interventions lifted the overall amount of Fed temporary liquidity $119.1 billion to $361.5 billion, the most outstanding since the Fed began doing repos again in September after a decade-long break." This is all in reaction to, as the New York Times reports, "reports from trading desks that many assets that are normally liquid—easy to buy and sell—were freezing up, with securities not trading widely. This was true of the bonds issued by municipalities and major corporations but, more curiously, also of Treasury bonds, normally the bedrock of the global financial system."

In general this week, in everything from stocks to bonds, gold to crypto, the Times notes, "major financial players are experiencing a cash crunch, and are selling whatever they can as a result. That would help explain the seeming contradiction of assets that should go up in value in a time of economic peril instead falling in value." That both stocks and bonds were falling this week put a big scare into the system.

Cynical populists might note that here, as so often, government's quick big-money interventions seemed aimed more at comforting the wealthy and high-powered as opposed to easing the problems of the mass of low-income wage-earners, renters, or others who might be devastated by the shutdown in economic activity commensurate with the shutting down of most public gatherings that's picking up speed this week.

That said, these repurchases function not as cash giveaways, but as loans that should be paid back. As CNBC explains, "Repos are short-term operations in which financial institutions provide high-quality collateral [in this case the wide variety of Treasuries and other securities] in exchange for cash reserves they use to operate."

As Politico puts it, these new repos are meant to be "a crucial source of overnight funding for brokerage firms, hedge funds and other financial institutions." The Fed hopes this new repo expansion will "ensure the proper functioning of the market for Treasuries, which influences all other credit markets."

Scott Sumner of the Mercatus Center, who writes from a "market monetarist" perspective that roughly believes the Fed has been too tight in overall monetary policy since the 2008 crisis, says via email that today's actions are "reactive, not proactive. Taken in isolation, they are probably beneficial. But the Fed needs to further ease monetary policy to assure that it achieves its policy goals, as set by Congress."

At his blog, Sumner suggests bold moves for the Fed such as an instant end to paying interest on bank reserves, as that policy is contractionary at a time we don't want contractionary monetary policy, and to straight-up purchase "as many Treasuries (and MBSs [morgage-backed securities]) right NOW as required to raised the expected price level two years from today to a level 4% higher than today. Not gradually; buy them NOW." (Emphasis his.)

As Cato Institute monetary policy maven George Selgin says in an email today, despite the total amounts of money involved in the repos, it is properly seen as a series of "temporary short-term loan allotments [that] aren't cumulative. It's like me offering you $5 to be repaid next Thursday, and then offering to lend you the same amount then, and again the following week. At no point am I lending more than $5, and always for a short term."

That said, Selgin also writes: "The question that remains to be answered is whether the Fed will also find it necessary to increase either the size or the duration of its ongoing, outright security purchases, which it so far plans to continue only through April. I should not be at all surprised to see an announcement sometime soon concerning such a decision." Selgin's larger-scale critique of the Fed's ways of managing monetary policy over the past few years can be found here.

This means that any possible wind-down of assets the Fed owns since the quantitative easing days post-2008 crisis seems over. That failure to wind-down is criticized today from a Misesian perspective for "constantly favoring and bailing out bankers and other parts of the financial sector, [which means] the Fed has put all other sectors and industries at a disadvantage. As a nonfinancial enterprise, it's hard to compete for investors and capital when the Fed has guaranteed that the financial sector will be bailed out no matter what."

The Fed's announcement had no immediate positive effects on stock market price plunges, with the Dow Jones Industrial Average down nearly 10 percent today.

For more background on the Fed's asset holdings, see this 2014 Reason feature by Jeffrey Hummel, "How the Fed Got Huge," assessing the economic dangers of the Federal Reserve being such a huge holder of financial assets.