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Steven Mnuchin Says U.S. Aims to Get Back Its Money From Fed Programs

Kate Davidson and Richard Rubin

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WASHINGTON -- Treasury Secretary Steven Mnuchin said he expects the government to recover funds it is committing to backstop the Federal Reserve's emergency lending programs, as it has in past crises.

Congress last month appropriated $454 billion to absorb possible losses on the Fed programs, which will provide trillions of dollars in loans to businesses and municipalities. The money from the Treasury serves as a buffer to protect the Fed against losses.

Some of Fed's investments may end up being profitable, while others will lose money, Mr. Mnuchin said on a conference call with reporters. All told, he said, the U.S. aims to least come out even.

"We're looking at it in a base case scenario that we recover our money," he said.

The Fed and Treasury profited from the emergency programs they set up during the 2007-09 financial crisis. But some economists said the coronavirus pandemic is different, because it extends beyond financial markets and is shutting down broad swaths of the economy, from retailers to airlines.

Mr. Mnuchin, seeking to manage expectations, said he's not setting out with losses in mind.

"If Congress wanted me to lose all the money, that money would have been designed as subsidies and grants as opposed to credit support," he said.

The Treasury has pledged $185 billion so far from the funds Congress provided to support roughly $2.3 trillion in lending by the central bank, including loans for states and municipalities and midsize businesses. Mr. Mnuchin said he's holding some money in reserve while he monitors the economy and the effectiveness of the programs.

A key question for Fed and Treasury officials, who have collaborated closely to design parameters for eligible borrowers, is how much risk they are willing to take. If eligibility for the programs is set too narrowly, credit might not flow freely enough to help many companies. If the parameters are too loose, more loans are likely to go bad, increasing the government's losses.

"We are clearly moving into areas where there is more risk than there has been in the past," Fed Chairman Jerome Powell said at an online briefing Wednesday. "And that's OK. That's what we are supposed to do."

However, Mr. Powell added that it is up to the Treasury to decide how much it is prepared to lose.

During the 2008-09 financial crisis, the government earned money on some of its rescue programs and lost money on others.

The government disbursed $443 billion through the Troubled Asset Relief Program and recouped all but $31 billion. It earned money on the equity stakes it took in banks, which it later sold, and lost money on stakes in auto makers.

The Treasury also collected hundreds of billions of dollars in interest from the Fed's huge portfolio of assets, which swelled during the crisis as a result of the central bank's bond-buying programs. In 2007, the Fed sent $34.6 billion in profits to the Treasury; that peaked at $97.7 billion in 2015.

It's less clear the government will make money this time around.

"This really is a different kind of downturn," said William English, economics professor at the Yale School of Management and former director of the Fed's monetary affairs division.

In 2008, the Fed's lending programs were designed to mitigate panic in the financial system and alleviate a liquidity crunch. Most firms were fundamentally sound and the credit programs allowed them to avoid failure, Mr. English said.

This time, the economy is slowing rapidly, as businesses across the country remain shut and millions of workers lose their jobs. A government report Wednesday showed that the gross domestic product shrank at a 4.8% annual rate in the first quarter, the steepest drop since 2008.

"A lot of businesses and households probably will not make it," Mr. English said. "So loans now are going to be really risky."

The Fed and the Treasury can adjust the parameters of the lending programs to calibrate the level of risk, for example, by changing the duration of loans or other measures.

But given how fast the economy is deteriorating, they don't have the time that's needed to fine-tune the degree of risk to avoid losses, said George Selgin, the director of the Cato Institute's Center for Monetary and Financial Alternatives. Two credit programs aimed at midsize companies and states and municipalities were announced April 9 and have yet to get under way.

"It's already taking too long," Mr. Selgin said. "If you want to help these businesses, you've got to be prepared to lose a lot of money."

Mr. Mnuchin contrasted the Fed's credit programs with other pieces of the economic relief law passed by Congress last month. The $292 billion in direct payments to Americans won't be paid back and aren't meant to be.

Congress also provided $660 billion for emergency loans to small businesses, known as the Paycheck Protection Program. Borrowers won't have to repay the money if they keep employees on their payrolls or hire them back by the end of June.

Mr. Mnuchin said he expected most of those loans to be converted to grants. And he rejected calls to relax a restriction that 75% of the money go for payroll costs.

"The purpose of the PPP was designed to put people back to work," he said.