Central Banks

Fed opens up toolkit to support flow of credit

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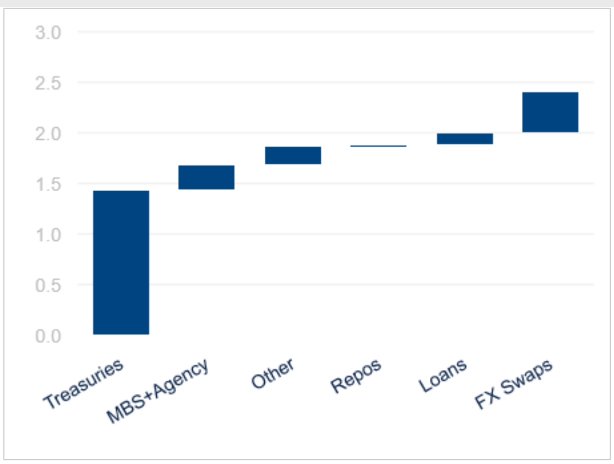
April's FOMC statement, released today, confirms that the Federal Reserve (Fed) will continue with its aggressive strategy to deal with the economic fallout and downside risks. One the one hand, the Fed acknowledged the severity of the crisis: "The coronavirus outbreak is causing tremendous human and economic hardship across the United States and around the world." On the other hand, it confirmed the elevated uncertainty and downside risks going forward: "The ongoing public health crisis will weigh heavily on economic activity, employment, and inflation in the near term, and poses considerable risks to the economic outlook over the medium term."

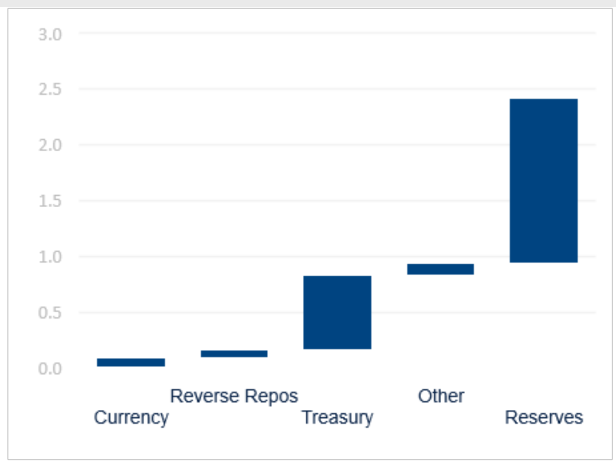
As a result, the Fed reaffirmed its commitment to maintaining interest rates at the zero lower bound until "... it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals." In addition, the Fed will continue purchasing Treasury, MBS and agency CMBS securities, engage in repo operations, reinvest principal payments and engage in dollar roll and coupon swap transactions, to restore market functioning and stability in financial conditions, and support the stance of monetary policy .

Figure 3. **Fed Assets: Change since 2/26 (US$tn)**



Source: BBVA Research, BEA & Haver Analytics

Figure 4 .**Fed Liabilities: Change since 2/26 (US$tn)**



Source: BBVA Research, BEA & Haver Analytics

In terms of the dry powder, the Chairman seemed confident in the lending facilities and the Fed's ability to "lend" to protect business, workers and households from insolvency. Doing so should limit, in his view, the long-term damage from the crisis. In fact, he reaffirmed that "[w]e will continue to use these powers forcefully, proactively and aggressively until we are confident we are solidly on the road to recovery." Besides leaving room for future flexibility in the large-scale asset purchase program, as we expected, the Fed did not announce the launch of more unconventional tools such as "yield curve control" or outright equity purchases.

Based on today's communication and news conference it seems the Fed's focus in the short-run will be trained on its lending programs. In fact, during the Q&A Chairman Powell said that while the details of the Main Street Lending Facility were still being considered and that a term sheet would be released soon, there was potential for the facility to expand further and potentially accept different types of loans.

With respect to interest rates, our baseline scenario continues to assume that policy rates remain at the ZLB at least through 2022. This also implies that the Fed will not move into negative territory. On the balance sheet, it seems that the largest growth in the coming quarters will come through the expansion of its lending facilities as the pace of asset purchases continues to taper off. Although the Fed will continue relying on QE to restore market functioning in the short-term, it is possible that over time the Fed will adopt a more traditional and smaller QE program with greater detail on forward guidance as it tries to revert back to a more "normal" monetary policy framework.