Economic Fallout: Here Comes Congress!

March 31, 2020

by Libby Cantrill, Tiffany Wilding

of PIMCO

The massive U.S. stimulus bill that President Trump signed last week is designed to help individuals and businesses facing disruption caused by the coronavirus. However, Congress may have to do more in the months ahead.

As we wrote recently, we thought additional fiscal stimulus was a matter of when, not if, given the growing economic and political imperative for the U.S. Congress to act. Fast forward a week – and what we thought would be a maximum $1 trillion package ballooned to $2.2 trillion, the biggest fiscal stimulus bill Congress has ever passed, and one that policymakers hope will stave off the long-term consequences of growing economic disruption associated with efforts to contain the coronavirus.

What's in the bill?

The nearly 900-page bill addresses relief for an expansive range of stakeholders – from individuals, children, and small businesses to large industries, states and municipalities, and financial markets. Some highlights:

- $350 billion for small businesses with 500 employees or fewer that will include eight weeks of cash assistance through loans, much of which will be forgiven if the company keeps workers on its payroll.
- $500 billion for the Treasury's Exchange Stabilization Fund, including up to $454 billion to be used as equity to support a series of forthcoming Federal Reserve credit facilities designed to provide liquidity to the financial markets across various industries (which is likely to be levered up to 10 times by the Fed, amounting to more than $4.5 trillion of market firepower). Of this, $50 billion is earmarked for passenger airlines (divided between loans and grants), $8 billion for cargo carriers, and $17 billion for "businesses critical to maintaining national security".
- $500 billion for individuals in the form of one-time payments of $1,200 per adult, $2,400 per couple, and $500 per child; the amounts begin phasing out gradually for individuals earning more than $75,000 and married couples earning over $150,000.
- $260 billion for emergency unemployment insurance, which includes funding for an additional 13 weeks of coverage (up to $600 per week) and covers part-time, self-employed, and gig economy workers.
- $150 billion for healthcare, including more than $100 billion for hospitals and public and nonprofit health organizations.
- $150 billion for state and local governments.
- Odds and ends, including the ability for borrowers of federally guaranteed mortgages to request forbearance for up to 12 months, student loan relief for borrowers of federal loans, and the waiving of tax penalties for those who draw from their retirement accounts for virus-related reasons.

Will it help?

Along with the actions taken by the Federal Reserve, we think these fiscal measures will prove to be a powerful backstop to the U.S. economy. The fiscal stimulus won't prevent a recession as the level of business activity drops due to mandated containment measures. Over 24 states have now issued nonessential business closures, affecting 10% of the labor force. However, by providing households and businesses with funding to bridge the gap in cash flows while the virus subsides, policymakers are helping to ensure the economy can stage a swift recovery and avoid the longer-term economic damage that can result from a wave of bankruptcies and a rise in the number of long-term unemployed.

The roughly $2.2 trillion stimulus package includes around $1.3 trillion (or 6% of GDP) support to households and businesses in the form of payments to individuals, loan forgiveness to firms, and additional funding for unemployment insurance, states, and hospitals. Although some of this money may not be immediately spent, since a majority of nonessential consumer businesses are closed, it will directly support household savings and over time can be deployed into the economy as the virus subsides.

On the timing of when these support activities will make their way back into the economy, we expect direct payments to individuals to start hitting bank accounts in early to mid May. Back on 17 March, Treasury Secretary Steven Mnuchin said it would take three weeks for the IRS to start making payments, but the income phase-out policy will likely take more time to administer. We note that in 2008, two months elapsed between when the stimulus bill was signed to when households received their checks. There will be some relief for consumers in the meantime – unemployment insurance usually begins paying out within two to three weeks of an initial claim, and the recent bill also included mortgage forbearance and student loan payment relief for federal loans.

Similarly, the small business loans will likely take some time to be administered, increasing the chance that many small businesses begin to close permanently before the government can save them. However, the government is also providing some support in the interim – according to the Small Business Administration's website, some businesses can also apply for an "express bridge loan" while they wait for the approval of larger loans authorized under the bill.

The remaining dollars will be used as a U.S. government guarantee on an estimated $4 trillion in possible lending capacity from the Federal Reserve, which has already announced several programs to support credit markets as well as businesses of all sizes. Currently, the Fed programs have focused on credit support to nonfinancial corporations of all sizes. The Fed has also introduced a number of programs to support banks and broker-dealers.

The goal of these various Fed facilities is to indirectly improve market functioning across a wider range of markets. However, that has so far yet to be seen. In particular, highly rated securitized product markets haven't seen any appreciable improvement in market functioning. In our view, the Fed may also need to include secondary purchases of a broader range of securitized products – including private label commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS), and collateralized loan obligations (CLOs) – in its Term Asset-Backed Securities Loan Facility (TALF). In addition, direct lending support to companies rated below investment grade, which employ an estimated seven million or more employees in the U.S., is so far absent.

In summary, although there is a question around how quickly and effectively the government programs can be dispersed around the economy, we think this level of support is a good start toward offsetting the economic costs of containing the virus.

What's next?

The U.S. president has signed the bill, and Congress will be in recess for the next several weeks. However, given the severity of the economic downturn, limited success thus far in containing the coronavirus, and the possibility of a resurgence in cases when restrictions are eased or when colder weather returns next fall, Congress may well need to take yet another bite at the apple when it returns at the end of April or early May.

As is usually the case with any government program, some markets and businesses have been left out. Namely, as mentioned above, support for large companies rated below investment grade and for highly rated securitized products remains absent, and it's unclear whether the lack of direct support to these areas will eventually cause a bigger problem for the economy. Broad-based bankruptcies across high yield companies could result in a larger economic headwind, while market volatility in areas like private label RMBS and CMBS could reduce credit and mortgage availability after businesses are back up and running.

At this point, it is unclear what additional stimulus would look like, but it could potentially include more funding for states and localities, which are on the frontlines of fighting the pandemic, as well as more support for individuals and small businesses, possible spending on infrastructure (a bipartisan priority for many members of Congress for years), and perhaps other spending to address industries that were not targeted in the latest stimulus.

Bottom line: Congress has acted in an unprecedented fashion and, to their credit, in an unprecedented time frame. But with economic conditions deteriorating, Congress may be forced to do even more in the coming months.

Libby Cantrill is PIMCO's head of public policy, and Tiffany Wilding is a PIMCO economist focusing on North America. Both are regular contributors to the PIMCO Blog.