COVID-19 and U.S. Responses

Brief Report

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The Desk

About The Desk

Hult London's The Courage newspaper and Hult Finance & Technology Society (HFX) have partnered up to create a project called **The Desk** - a weekly newsletter program that provides updates on Company activities, Financial Markets and Economies.

The Desk's mission is to equip the community at Hult International Business School with the necessary economic awareness.

Our vision is to become Hult's largest financial media outlet across all 5 Global Campuses in London, Boston, San Francisco, Shanghai and Dubai.

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Introduction

The COVID-19 pandemic outbreak continues to change the world economy and sociology. As of 28th April 2020, total confirmed cases amount to more than 3 million with 210,000 deaths (John Hopkins university, 2020). As health crisis episodes unfold, it is apparent that the macroeconomic resilience of sovereign states are being tested amidst an unprecedented global economic lockdown. Following months of inactivity, businesses ranging from large corporations to SMEs are forced into a credit-crunch environment on top of a non-systematic demand crash, which have resulted in almost 2,200 retail chains filing for Chapter 7 and 11 bankruptcy as they expect to become insolvent (Cain, 2020). Whether it is a Black or White Swan event, COVID-19 has officially initiated a global-scale experiment on a controversial economic theory called Modern Monetary Theory (MMT). The aforementioned credit-crunch environment leaves powerhouse central banks such as the Federal Reserve System (FED) and European Central Bank (ECB) to introduce new lending facilities and asset-purchase programs as pillar pipelines to pump unprecedented liquidity levels into their troubled economies.

Most notably, on 19th March 2020, the United States Congress passed the US$ 2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act to cushion pandemic and lockdown impacts on households and businesses of all sizes (Zezas, 2020). Alongside its fiscal counterpart - U.S. Treasury, the FED announced an unprecedented US$ 1.5 trillion injection to regain normal Treasury purchase patterns as a response to the pandemic's negative effects on financial markets' liquidity (Timiraos & Verlaine, 2020). For troubled Eurozone economies, the ECB announced on 18th March 2020 their historic €750 billion Pandemic Emergency Purchase Programme (PEPP) as a strong temporary monetary policy tool to provide liquidity for financial markets (ECB, 2020). On the fiscal side, although ratified EU Treaties oppose state aid in its single-market zone, member states have been implementing their own fiscal stimuli with the approved €37 billion in liquidity backstop coming from the EU Budget.

Both historic regional stimuli in capitalist markets may act as an inflection point to the debate about government intervention. This report borrows the rhetoric of this debate and analyses the current fiscal and monetary responses to the COVID-19 pandemic to briefly reveal impacts of the on-going event on the macroeconomy of the U.S.

Coronavirus Aid, Relief, and Economic Security (CARES) Act

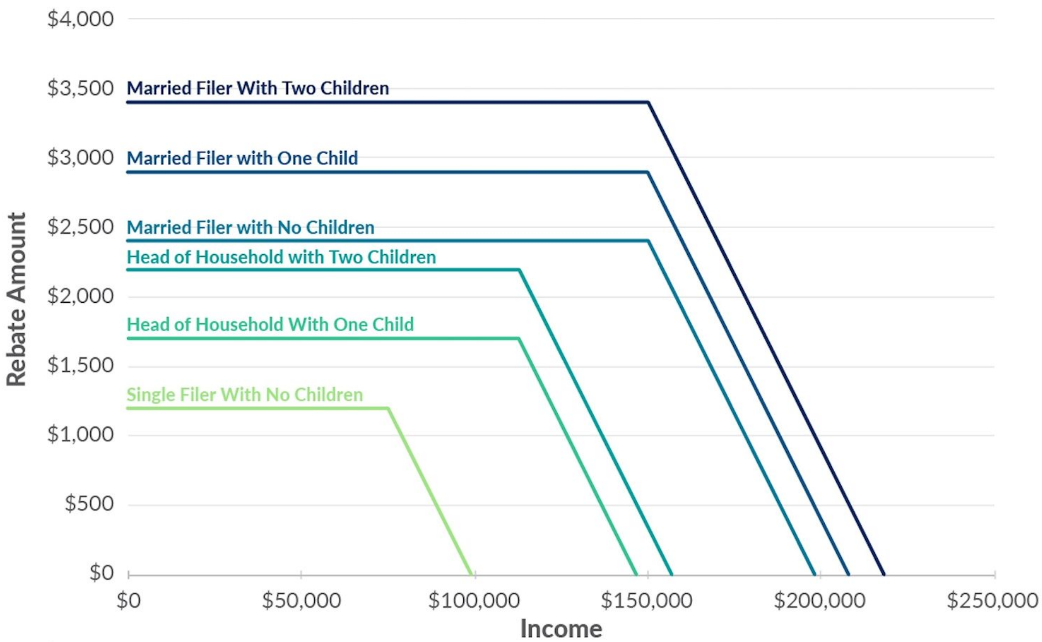

Figure 1. *Recovery Rebate Amount Phase Out Based on Annual Salary*
Source: *Morgan Stanley Research*

Firstly, individuals with $75,000 in annual income or less are eligible for a US$1,200 worth of tax rebate in a form of direct payment. Payment brackets increase as official family members increase with respect to levels of income. In addition, families with more than two children are able to receive US$500 per additional child. These tax rebate direct payments are on top of eligible benefits from unemployment insurance that is also introduced in the CARES Act. The second household benefit is the Pandemic Unemployment Insurance (PUI). The unemployment insurance extends the normal unemployment benefit duration of 26 weeks into 39 weeks, bringing the total duration to around 9 months. Most notably, the PUI extends the range of eligible applicants to include those with independent contractors, part-time contracts and 'gig-economy' contracts. Most importantly, the CARES act adds on top of existing unemployment benefits an amount of US$ 600 per week from April until August, further stretching the lifeline for employees recently made redundant by the pandemic (Zezas, 2020).

Direct impacts of COVID-19 on the U.S. workforce

From the above summary, the juggernaut US$ 2 trillion CARES Act reveals an uncomfortable reality of this pandemic's impacts on the U.S. economy: the lower class may not be able to recover. Already as of late April, there are 26 million initial jobless claims outstanding in the U.S. which amounted to a 1 percent increase in unemployment rate since February. The amount of U.S. employment losses since the outbreak now has officially cancelled out all 22 million employment gains since the 2008 financial crisis. The unemployment rate now sits at 4.4 percent but is believed by economists, academics and U.S. Treasury Secretary Steve Mnuchin to possibly could reach 20 percent if without the CARES Act (Wingrove et al., 2020).

The most heavy hit U.S. sectors are those with business models relying on cyclical booms of the economy, when consumers are incentivised to spend more on travel, leisure, and discretionary goods as opposed to regular staple goods. These sectors therefore include airlines, theme parks, hotel chains, restaurant chains, cinemas etc. who are now furloughing and laying off mass waves of their own workers as the quickest attempt to rapidly cut direct and associated labour costs to meet liquidity standards to stay solvent in times when cash inflows dry out. For instance, Disney's chain of theme parks has furloughed more than 100,000 workers. Similar number of furloughs is applied to Macy's, Marriott, Kohl's Caesar Entertainment, etc. across the U.S. which is a staggering number of workers, the majority of whom are low-skilled, living without monthly paychecks to support their families (USA Today, 2020).

Figure 2. *U.S. Initial jobless claims as of week ending March 28th*
Source: *Financial Times*

Indirect impacts of COVID-19 on the U.S. workforce

The CARES Act will be a new gravitational force in U.S. bipartisan politics when the debates of universal basic income and employment benefits are raised as respect to the grand-scheme of 'welfare economics' debate. As mentioned, U.S. Treasury Secretary Steve Mnuchin, who is a Republican, stated that without the cushioning CARES Act, the employment downfall would be astronomical. An implicit interpretation could reveal the Repulican Secretary's acknowledgement of the importance of government intervention to support the economy which contrasts the typical Republican free-market agenda. The Secretary is known for his strong support for the repeal of the Dodd-Frank Act and the Volcker rule, which introduced stronger financial supervisory systems after the 2008 financial crisis to prevent banking imprudence, on behalf of the free-market agenda of the Republican party (Schlesinger, 2016). President Trump's signing of the CARES Act is within itself a contradiction to the free-market agenda. Leaving behind this pandemic, future macroeconomic and fiscal policy debates will orbit around this historic government fiscal stimulus as the act has brought a fundamental revelation to the effectiveness of the U.S. welfare policies prior to the pandemic.

The CARES Act also will possibly leave behind a transitional force in the U.S. labour market. The current dependency over online platforms for work may reveal a possible shift towards a preference over 'work from home' (WFH) jobs as opposed to office ones. Matt Mullenwerg, CEO of WordPress and owner of social media Tumblr, states that regular office workers might now prefer the avoidance of "long commutes" and "inflexibility". He also states that workers may now appreciate being closer to family members during the workday (Hern, 2020). Tech companies such as Microsoft, Google and Slack are already accommodating this mass transition towards WFH labour by offering free online premium workplace-collaboration services and premium cloud-hosting services (Hern, 2020). As mentioned, the CARES Act's inclusive PUI coverage for part-time workers, gig economy workers potentially reveals a future favourable welfare coverage for these WFH jobs, which incentives workers in the labour market to shift their demand towards these occupancies or employers who may provide such jobs.

Borrowing the CARES Act's goals and composites, revelations are made about the direct and indirect impacts of COVID-19 on the U.S. unemployment figures as well as potential shifts in patterns and behaviours of the U.S. workforce.

United States' Monetary Responses

Federal Reserve's Liquidity Pump

Date	*Facility*	*Acronym*
March 17	Commercial Paper Funding Facility	CPFF
	Primary Dealer Credit Facility	PDCF
March 18	Money Market Mutual Fun Liquidity Facility	MMLF
March 23	Primary Market Corporate Credit Facility	PMCCF
	Secondary Market Corporate Credit Facility	CMCCF
	Term Asset-Backed Securities Loan Facility	TALF
April 9	Paycheck Protection Program Liquidity Facility	PPPLF
	Main Street Business Lending Program	
	Municipal Liquidity Facility	

Figure 3. *Federal Reserve's list of liquidity facilities as a response to the COVID-19 pandemic*
Source: *The American Action Forum*

During such tumultuous times for financial markets, when credit becomes squeezed due to banks' inability and unwillingness to lend to troubled businesses across the faltering economy, the Federal Reserve (FED) has a responsibility to exercise their political independence and monetary power in order to ease credit by lowering short-term interest rates. The FED can directly achieve this by ramping up their short-term bond purchasing programs to artificially drive up bond prices and lowering short-term interest rates. From Figure 3, the programs that have already existed since the 2008 financial crisis are the Commercial Paper Funding Facility (CPFF), Primary Dealer Credit Facility (PDCF) and Money Market Mutual Fund Liquidity Facility (MMLF). Therefore, due to the COVID-19's impacts on financial markets alone, the FED has introduced at least 6 new main liquidity facilities to tackle the current credit crunch in money markets. The aforementioned US$ 1.5 trillion in liquidity pool has now been upgraded to a *de facto* 'unlimited' bond purchasing plan (Smialek, 2020). This means that the FED and its Federal Open Market Committee (FOMC) is now using all of their facilities to rapidly increase the money supply in the economy by purchasing from a range of government bonds, including Treasuries and municipal bonds; corporate bonds, including borderline investment-grade bonds, asset-backed securities and bonds-backed ETFs; in both primary and secondary markets, and from both primary dealers and directly from corporations (New York Fed, 2020).

Unprecedentedly, the FED's extensive list of liquidity facilities reach nearly all major players in money markets specifically and financial markets generally. Prior to this pandemic, the FED's repurchase agreement (REPO) and any lending facility never operated at this level. The FED decided to officially adopt such an aggressive monetary easing plan starting from mid-March after their REPO operations - ranging from overnight to 14-day operations - continuously experienced oversubscriptions from primary dealers desperate for reserves injection to repay demanding creditors as the U.S. economy began absorbing the impacts of the virus. For instance, the FED's 14-day US$20 billion REPO offering was oversubscribed by 3.2 times from broker-dealers (Oh, 2020). In an overheated money market where all players rush to the 'lender of last resort', the FED now has to outsource their 'desk' operations by paying the world's largest money manager BlackRock to manage three of their bond purchasing programs (Goldstein, 2020). The central bank has changed the way it operates traditionally as unprecedented monetary tools and pipelines unfold after its Chairman - Jerome Powell - cut rates to 0-0.25 percent range and reinitiate quantitative easing (QE) by purchasing longer-term assets (Smialek, 2020) which drives up the FED's total assets to a historic US$ 6 trillion amidst a recession.

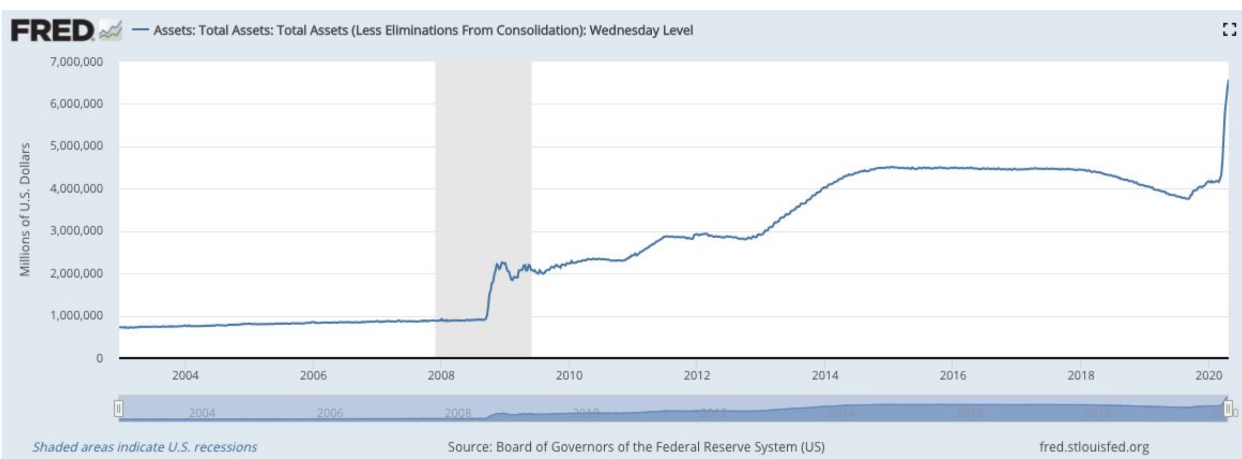

Figure 4. *Federal Reserve's Total Assets*
Source: *Federal Reserve Economic Data*

Revelations about impacts of COVID-19 on the U.S. macroeconomy

As mentioned, the unorthodox level, range and scale of the FED's monetary policy easing can have consequences stemming from its primary dealers, brokers and beneficiaries' moral hazard. For instance, many hedge funds and large corporations have been manipulating their workforce numbers to apply for the FED's early-April US$ 350 billion Payment Protection Program (PPP) which is designed to channel liquidity directly to small-to-medium businesses so that employers can run payrolls for their employees. This means that heavily-leveraged hedge funds, private university endowments, and better-off corporations are benefiting from the liquidity pool made for worst-off SMEs and low-skilled workers who struggle to reach monthly payments. The reality is that the PPP has already depleted and its true effectiveness, which is how well it acts as a safety net for SMEs, is hindered. The U.S. Congress already has injected another US$ 320 billion into the PPP but eligibility has not accommodated the necessary change to support SMEs (Wiltermuth, 2020). This exploitation means that low-skilled workers will continue to struggle with payments and insolvent SMEs will be forced to close down indefinitely.

Through the FED's aggressive measures, one major revelation about the state of the U.S.' capital markets is how overly levered corporations have been prior to the COVID-19 outbreak. Ever since the end of the 2008 crisis, U.S. corporations have been issuing 78 percent more debt, bringing the nominal debt corporate value to US$ 6.6 trillion which accounts for nearly 40 percent of total public debt. The accumulation of this is due to the FED's Zero Interest Rate Policy (ZIRP) from 2008 to 2015 as an expansionary monetary policy to ensure the economy quickly recovers from the Great Recession (Cox, 2020). Due to favourable borrowing rates, corporations have been levered up to fund capital expenditures (CapEx), asset purchases, and most controversially stock buybacks. Debt financed stock buybacks have been exercised by U.S. corporations more excessively in mid-2019 when almost half of stock buybacks were financed by long-term debt issued (Light, 2019). Unfortunately, the consequence of this is an artificial drive-up of share prices instead of performance-backed fundamental appreciation in prices. The result of this highly leveraged and imprudent practice is the desperation for liquidity when a credit crunch hits, which ironically has arrived due to a Black Swan health crisis. Due to the unpredictable nature of this health crisis, highly leveraged corporations did not have time for capital restructuring, refinancing or de-levering; therefore the desperation for the FED's reserves have pushed Powell to relentlessly pump liquidity to save potentially insolvent companies.

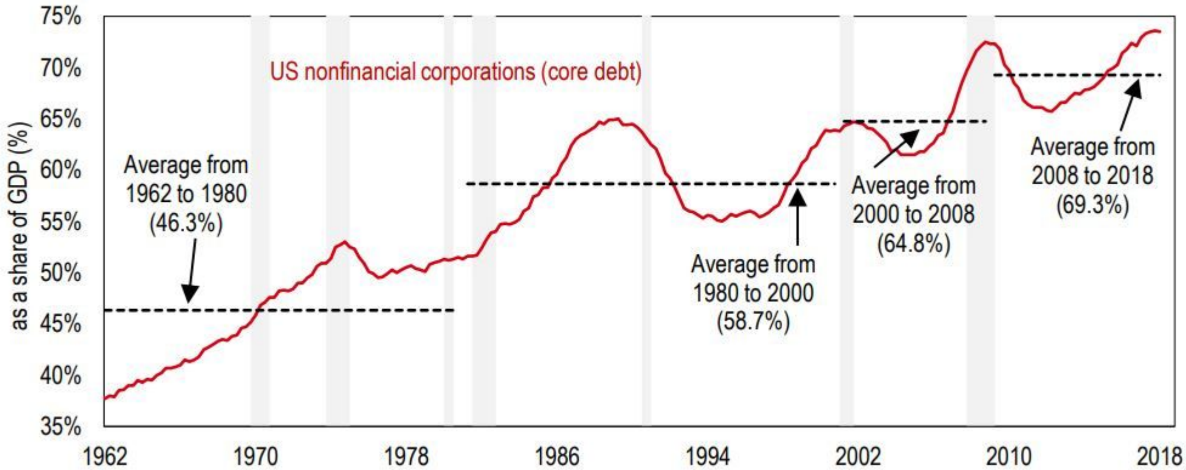

Figure 5. *U.S. nonfinancial corporate debt as percentage of U.S. GDP*
Source: *HSBC*

Moody's outlook for the US$ 6.6 trillion in nonfinancial corporate debt has gone 'negative' and Goldman Sachs stated that US$ 765 billion worth of investment-grade debt have already become 'fallen angels' in 2020 alone. This means that the corporations whose liabilities are accounted for in this US$ 765 billion will now have to pay more in annual interest payments as their ratings have been downgraded to 'junk status'. In this recession which demand remains low until lockdown is fully lifted, these 'fallen angels' are greatly suffering from liquidity issues coupled with their stock price plummeting. The most noticeable case-in-point are highly leveraged airlines who have been using 96 percent of their free cash flow on stock buybacks from 2010 to 2019 (Fox, 2020).

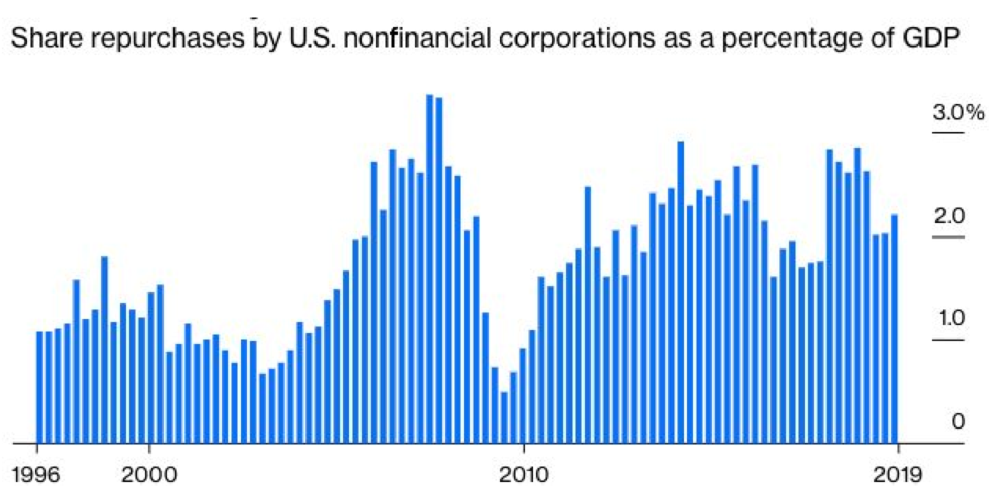

Figure 6. *U.S. nonfinancial corporation stock buyback as percentage of U.S. GDP*
Source: *Bloomberg*

The FED's aggressive and rapid money supply pump in such an extraordinary time reveals a blurring oppositional view against Modern Monetary Theory (MMT). After a series of liquidity pump introductions, FED Chairman Jerome Powell's Gallup Poll approval rating has now reached 58 percent - the highest FED Chairman approval rating since Alan Greenspan's 56 percent in 2005 (Reinicke, 2020). The positive sentiment around Powell's new programs therefore align with those who agree with the principles of MMT as the FED and the U.S. Treasury's discussed programs are the apparatus of this macro-scale MMT experiment. Both sides of the current paradigmatic debate between pro-intervention Keynesians and pro-market classical economists will be tested by the effectiveness of Powell's COVID-19 monetary response. From lessons learned in 2008's government intervention and even more robust 2020's response, neo-Keynesianism ideas such as MMT may become more relevant and applicable in the macroeconomy of the U.S.

The same view about MMT's application may not be so for other emerging economies. The revelation comes from the FED's REPO facility for Foreign and International Monetary Authorities (FIMA) (Politi, 2020). In this global economic crisis, FIMA acts as a direct currency swap line from the FED to other major central banks to meet foreign demands for the U.S. dollar and as a way for the FED to avoid further mass selling of U.S. Treasuries from foreign central banks - which drives up short-term interest rates in the U.S. This facility reveals and further makes emphasis on the importance of the U.S. dollar in international trade and capital flows. As corporations and investors have always flocked to the strong U.S. dollar in troubled times due to it being the reserve currency, for instance the 2001 Argentine crisis, the Tequila crisis, and the Zimbabwe crisis, foreign countries especially in emerging and frontier markets cannot solely rely on MMT's loose budgetary deficit principle to boost demand in their economies as capital flight towards the dollar would ensue which then devalues their domestic currency and leads to dollar-denominated debt repayments backed by excessive money printing causing potentially hyperinflation. From the COVID-19 crisis, global demand for the U.S. dollar has caused the reserve currency to appreciate in value against many emerging economies whose dollar-denominated debt is at a substantial level. For instance, Turkey is one of the U.S.' largest debtors and now their currency 'Turkish lira' has been suffering from a massive devaluation against the appreciating U.S. dollar. As part of a vicious cycle, Turkish Central Bank rushes to print more 'liras' and exchange them for U.S. dollars to repay appreciating dollar-denominated debt.

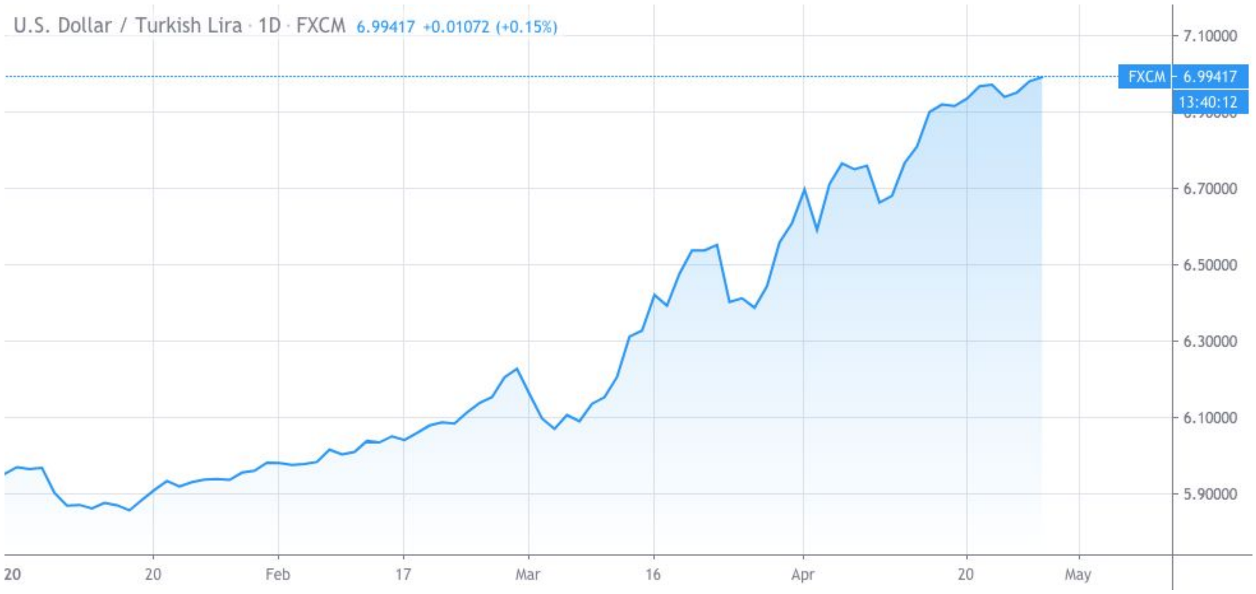

Figure 6. *USD/TRY YTD Chart*
Source: *TradingView*

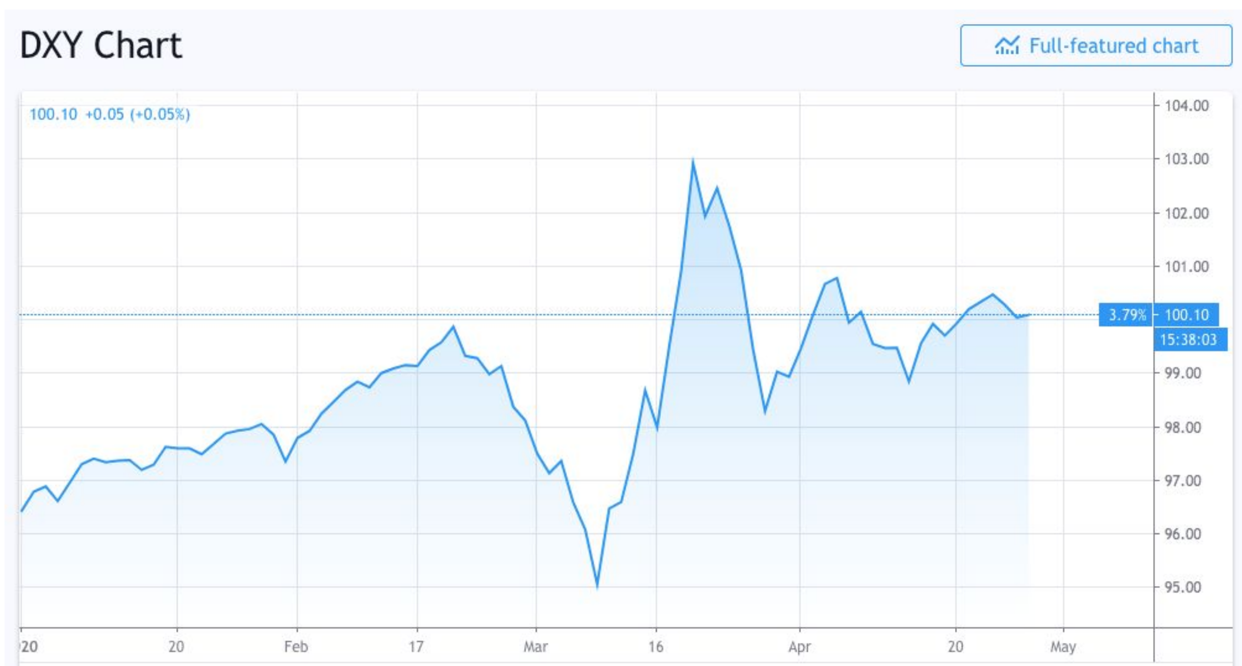

Figure 7. *Dollar Currency Index (DXY)* YTD Chart*
Source: *TradingView*

Dollar Currency Index (DXY) is an FED index developed to track the U.S. dollar's strength against a basket of major foreign currencies including the EUR, JPY, GBP, CAD, SEK, CHF.

Closing remarks

One topic which the report would touch more upon if word count limits had allowed is the effects of the COVID-19 pandemic on the European Union's existential crisis. Prior to the pandemic, the single-market economies suffer from pre-existing asymmetric shocks which undermines the EU leaders further integration agenda. The asymmetric shock, exacerbated by the prolonged Greek debt crisis and the 2015 migration crisis, is now being exacerbated by this health crisis. Without a common budgetary union and without more solidarity in the Eurozone, EU scepticism will grow as worse-off member states wonder whether this is a market or political project.

The report borrows the recent U.S. fiscal and monetary stimuli to point out certain explicit and implicit impacts of the COVID-19 pandemic on primarily the United States. The U.S.' fiscal CARES Act reveals a certain magnified blow to the U.S. labour force after a short run of historically low unemployment rates, alongside a necessary debate revolving around state aid and welfare for future political checks and balances. The FED continues to operate 'unlimited' liquidity pipelines into the economy to ease the credit environment and encourage financial markets to behave without adverse volatility. The FED's extensive monetary policies and programs also reveal a potentially new perspective on the pre-existing paradigms in different and very much opposing macroeconomic schools of thought. One of which is how the United States could exercise its 'exorbitant privilege' to increase its influence on global credit markets and subsequently its political power on the globalised world stage.

The COVID-19 pandemic is now the modern world's greatest macroeconomic and multilateralism stress test. It is a stress test to identify social gaps in the United States' capitalism. It is a stress test to Europe's ability to provide a safety net equally for all member states in its supranational system. The COVID-19 pandemic is also a stress test to humanity as it reveals the most consequential wakeup call yet, for politicians and citizens alike, about the importance of biodiversity, climate action and solidarity not just in crises but in times of norm.

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