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The Federal Reserve's Early Response to the COVID-19 Pandemic

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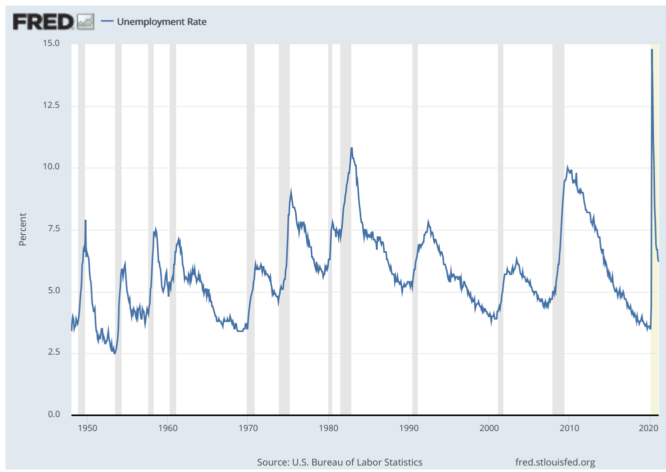
The Federal Reserve (the "Fed") conducts monetary policy in accordance with its mandate from Congress: to promote maximum employment and stable prices in the economy. Because financial stability is an important prerequisite for achieving these goals, the Fed also takes actions to help ensure that financial institutions and financial markets are able to efficiently channel the flow of credit to households, communities, and businesses. When the COVID-19 virus unexpectedly surfaced in early 2020, the ensuing global pandemic swiftly led to uncertainty about the future of economic growth and put stresses on financial markets. It is not surprising that the Fed took rapid and forceful actions.

Though primarily a health crisis, the COVID-19 shock was felt throughout the U.S. economy. As health agencies and various levels of government advised widespread shutdowns to slow the spread of the virus, the economy ground to a halt in the spring of 2020.[1] As seen in Figure 1, the unemployment rate surged to an 80-year high—to 14.7 percent in April and 13.3 percent in May. More jobs were lost in March and April than had been created over the preceding expansion, which lasted nine years. Because the path for the economy was so uncertain, many businesses and investors sought to increase their holdings of cash and other very "liquid" assets. This flight to cash resulted in financial markets becoming volatile and disrupted. Even the U.S. Treasury securities market, which is among the most liquid market in the world and where companies expect to be able to quickly sell these securities to raise money to finance operations, saw stresses that made it difficult for trades to occur.[2]

Spurred by its mandate and concern for financial stability, the Fed took quick and forceful actions to minimize economic harm and set the stage for an economic recovery when the worst was over. The Fed leaned on its full range of tools to restore market function and support the flow of credit to households, businesses of all sizes, and state and local governments. Some

Figure 1. **Unemployment Rate, 1948 – 2020**

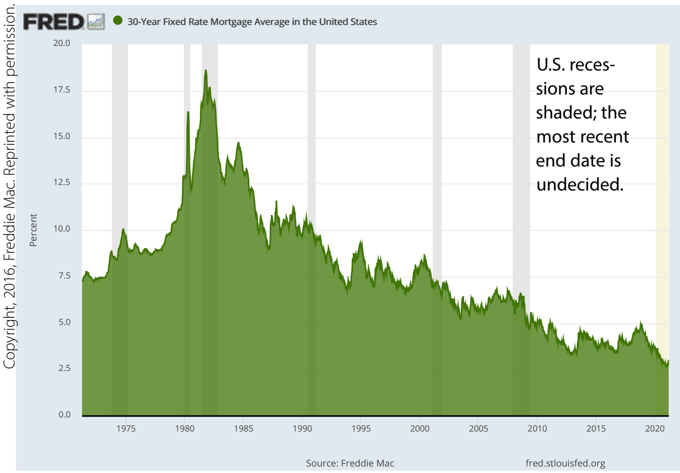


SOURCE: FRED®, Federal Reserve Bank of St. Louis; the most recent end date is undecided, U.S. recessions are shaded. https://fred.stlouisfed.org/graph/?g=xvvl

actions relied on traditional tools that the Fed uses when the economy slows, while others were nontraditional measures only used in times of severe stress. Its actions can be classified into three categories. First, it used its standard interest rate policy tool. Second, it used balance sheet policy, meaning purchases of "government" securities. Third, it deployed other liquidity and credit measures that predominantly included the establishment of emergency lending facilities.

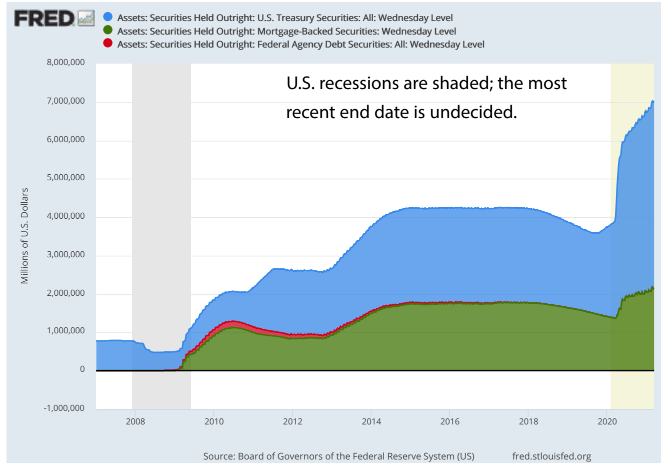
In early March 2020, the Federal Open Market Committee (FOMC)—the monetary policy decision making committee—held two unscheduled meetings. Acknowledging that the COVID-19 shock was going to weigh on economic activity in the near term and pose risks to the economic outlook going forward, it lowered the target range for the federal funds rate (the Fed's policy rate) a total of 1.5 percentage points—all the way to near zero. The FOMC also used forward guidance to

Figure 2. **Average 30-Year Fixed Rate Mortgage**



SOURCE: FRED®, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/graph/?g=xlpj

Figure 3. **Federal Reserve Securities Holdings**



SOURCE: FRED®, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/graph/?g=xOw8

note that it expected this policy rate to remain at the effective lower bound for quite some time. Consistent with this statement, the vast majority of FOMC policymakers reported in their December 2020 summary of economic projections that they expected the target range for the federal funds rate to be at the effective lower bound (0% - 0.25%) through at least the end of 2023. Both the lowering of the target range and the forward guidance of its future intent of the policy interest rate helps to push down other market interest rates, which should make it easier for consumers to borrow and for businesses to remain open and keep workers on the job. For example, the interest rate on a 30-year fixed rate mortgage dipped below 2.7 percent in December 2020, a fifty-year low (see Figure 2).

Around this same time, in response to the deterioration in trading of some of the most important securities markets, the Fed leaned on its balance sheet policy to start large purchases of Treasury securities and agency mortgage-backed securities (MBS)—a type of financial asset (like a bond) that is a pool of home loans.[3] The FOMC announced that it would purchase Treasury securities and agency MBS in the amounts needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions. This action provided liquidity by injecting cash into seized financial markets, and it also served as an important backstop to the market—giving buyers and sellers confidence that the Fed would be active in these markets to keep them operating. As seen in Figure 3, the Fed's securities holdings grew substantially in 2020, increasing $2.8 trillion between March and the end of the year. Early on during the pandemic, the Fed's weekly purchases peaked at approximately $350 billion for Treasury securities (the blue region) and $180 billion for agency MBS (the green region). As financial market stabilized, the pace of purchases gradually declined. And, by late 2020, the FOMC reduced its weekly purchases to an average pace of about $20 billion for Treasury securities and $10 billion for agency MBS. By the end of 2020, the FOMC noted that the more moderate pace of purchases was both helping foster smooth market functioning and accommodative financial conditions that would support the flow of credit to households and businesses.

Another action the Fed took was to introduce several temporary lending and funding facilities to support the flow of credit to businesses, households and communities where it was not otherwise available. These facilities are formal financial assistance programs offered by the Fed to help eligible borrowers with funding needs. The Fed is authorized to use these lending—not spending—powers only in unusual and exigent circumstances and with the approval of the Treasury Secretary. These facilities provided an important backstop to financial market participants when they were looking to sell assets for cash in the stressed environment; the establishment of these facilities provided confidence to traders that they would be able to find a place to exchange assets for cash, if needed, and ultimately allowed markets to return to normal operations with limited usage of the Fed's facilities.

One facility that saw take-up was the Paycheck Protection Program Liquidity Facility. Lending under this facility built up rapidly after its launch and continued to rise through the summer of 2020, peaking around $70 billion in early August. This facility worked to support the related Paycheck Protection Program created by the Coronavirus Aid, Relief, and Economic Security (CARES) Act passed by Congress, signed by the president, and administered by the Small Business Association, which provides funds to help small businesses operate and keep their workers on the payroll. In November, the Treasury Secretary announced the decision to close for new lending and new purchases of assets those facilities that used CARES Act funding after December 31, 2020; the Federal Reserve Board announced an extension of the remaining lending facilities that act as backstops to critical short-term funding markets through March 2021.[4]

Overall, the COVID-19 pandemic caused substantial disruptions to financial markets and the economy. As a result, the Fed has responded forcefully with interest rate policies to support the economy as well as a number of actions to stabilize financial markets and restore the flow of credit to many sectors of the economy. Together with the fiscal actions of Congress and the administration, these steps helped financial markets resume more normal functioning and created conditions to support an economic recovery. Of course, the path and timing of the recovery was subject to great uncertainty, and so, Chair Powell noted on December 1, 2020, "Everything the Fed does is in service to our public mission. We are committed to using our full range of tools to support the economy and to help assure that the recovery from this difficult period will be as robust as possible on behalf of communities, families, and businesses across the country."[5]

Notes

1. See Jane Ihrig, Gretchen C. Weinbach, and Scott A. Wolla, "COVID-19's Effects on the Economy and the Fed's Response," *Page One Economics®* (September 2020), for a timeline of key COVID-19 actions in the United States as well as discussion of the impact on various economic and financial data over the first few months of the pandemic. https://research.stlouisfed.org/publications/page1-econ/2020/08/10/covid-19s-effects-on-the-economy-and-the-feds-response
2. For a detailed discussion of the turmoil in the Treasury market in the first few months of COVID-19, see the November 2020 Financial Stability Report (www.federalreserve.gov/publications/financial-stability-report.htm).
3. The Fed first conducted repurchase agreements (repos)—temporary purchases. Once the Fed began purchasing securities in the open market, these repo operations ended. See Logan (Oct 2020) for an overview of the open market operations conducted by the Fed in the early days of the Fed's COVID response (www.newyorkfed.org/newsevents/speeches/2020/log201023).
4. See the Treasury Secretary's November 19, 2020 letter (https://home.treasury.gov/news/press-releases/sm1190) as well as the Fed's November 30, 2020 statement (www.federalreserve.gov/newsevents/pressreleases/monetary202011 30a.htm) outlining the future course of the various facilities.
5. Jerome Powell, "Coronavirus Aid, Relief, and Economic Security Act: Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C." Board of Governors of the Federal Reserve System, December 1, 2020. See www.federalreserve.gov/newsevents/testimony/powell20201201a.htm
6. FRED®, Federal Reserve Bank of St. Louis; See https://research.stlouisfed.org/dashboard/49765
7. Jane Ihrig, Gretchen C. Weinbach, and Scott A. Wolla, "How the Fed Has Responded to the COVID-19 Pandemic" Open Vault Blog (August 12, 2020). See www.stlouisfed.org/open-vault/2020/august/fed-response-covid19-pandemic
8. Ihrig, Weinbach, and Wolla, "COVID-19's Effects on the Economy and the Fed's Response."
9. Coronavirus Disease 2019 (COVID-19), Board of Governors of the Federal Reserve System. See www.federalreserve.gov/covid-19.htm

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In the Classroom

Students have likely felt the effects of the COVID-19 pandemic in many ways—perhaps in terms of the sickness of a friend or family member, but certainly in economic terms. Shutdowns and social distancing have likely changed the way their family shops, the way they learn, and how they interact with friends. As such, the pandemic provides teachers with an opportunity to teach important and relevant economic concepts about events that have deep meaning for students. To assist these efforts in the classroom, the Federal Reserve has created resources that can help.

- The speed and scope of the economic slowdown is reflected in economic data. The FRED Data Dashboard: COVID-19 Economics Data Tracking (**https://research.stlouisfed.org/dashboard/49765**), provides key economic data on one page. And because it's FRED data, it's updated every time you access, or refresh, the webpage.[6]
- The story of the Fed's early response is available in two classroom friendly articles from the Federal Reserve Bank of St. Louis. The first piece is a blog that can be assigned to students as a short read that provides a first look at the Fed's COVID-19 response, Open Vault Blog, "How the Fed Has Responded to the COVID-19 Pandemic" (**www.stlouisfed.org/open-vault/2020/august/fed-response-covid19-pandemic**).[7] The second article is a bit longer, provides a few more details, and includes a classroom assessment. *Page One Economics*, "COVID-19's Effects on the Economy and the Fed's Response" is available in the popular Econ Lowdown online learning platform (**https://research.stlouisfed.org/publications/page1-econ/2020/08/10/covid-19s-effects-on-the-economy-and-the-feds-response**).[8]
- A resource that aggregates many of the Fed's COVID materials is found on the Federal Reserve Board of Governors website (**www.federalreserve.gov/covid-19.htm**). This webpage includes relevant speeches, articles, and announcements about the economic effects of COVID-19 and the Fed's response.[9]