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Fed Expands Corporate-Debt Backstops, Unveils New Programs to Aid States, Cities and Small Businesses.

Latest round of emergency measures expands central bank's footprint into credit markets it has previously avoided

The Federal Reserve is going farther than ever to shore up the U.S. economy, unveiling programs to lend directly to states, cities and midsize businesses that have seen revenues evaporate amid efforts to combat the novel coronavirus.

The central bank also said Thursday it would expand previously announced plans to backstop lending to large companies by supporting riskier bonds issued by corporations that had recently lost their investment-grade status.

Altogether, the Fed said nine lending programs it is creating or expanding would provide up to $2.3 trillion in loans, and officials signaled they were prepared to expand those programs as needed to stem long-lasting damage to the U.S. economy.

"It's really an awesome display of creativity and decisiveness—the breadth and diversity of programs," said Antonio Weiss, a Treasury official in the Obama administration who is now a senior fellow at Harvard University's John F. Kennedy School of Government. "They are taking a role well beyond any the Fed has played in its modern history, and the economy needs it."

In leading the Fed beyond past efforts to support lending during the Great Depression or after the 2008 financial crisis, Chairman Jerome Powell is pushing deeper into areas of credit and fiscal policy that the central bank has traditionally deferred to elected officials.

During and after the financial crisis, the Fed left it to the White House and Congress to provide financial assistance to failing auto makers and local governments facing declining revenues and rising expenses, viewing such decisions as essentially political.

Now, with a far broader swath of the economy shut down to prevent the spread of infection, companies and local governments of all sizes are struggling to make payroll, pay bills and service their debts.

The Fed last month cut its benchmark rate to near zero at two unscheduled meetings and has ramped up purchases of Treasury and mortgage-backed securities at an unprecedented scale. Its asset portfolio has quickly ballooned to more than $6 trillion from $4.2 trillion in February, and it is on pace to more than double by midyear from its prior high of $4.5 trillion.

"The Fed is at war against the virus, and this is a wartime degree of commitment to credit policy," said Krishna Guha, vice chairman of Evercore ISI.

The superlatives the Fed is setting with the scale of its response have been matched by the speed with which unemployment is rising. An all-time high 7.5 million Americans were receiving

unemployment benefits at the end of March, the Labor Department reported Thursday. Another 6.6 million had submitted claims during the week ended April 4.

The severe scale of damage has prompted the Fed to signal its willingness to buy assets or make loans in any market it thinks will be necessary to stave off further job losses and business failures.

The Fed has tried to identify "the priority areas where we thought help was needed," Mr. Powell said during an online forum Thursday. "As we identify other areas, we won't hesitate to move."

Mr. Powell also said it would be important to defer to health authorities in determining how to reopen the economy. "We need to have a plan nationally," he said. "We all want it to happen as quickly as possible. We all want to avoid a false start."

The Fed first moved in funding markets last month to prevent a public-health crisis from morphing into a financial crisis, and later said it would assist credit markets that have broken down.

The Fed's initial response borrowed heavily from the programs developed by former Chairman Ben Bernanke, who during the 2008 financial crisis used lending authorities the Fed hadn't employed since the Great Depression.

Having exhausted those off-the-shelf tools, the Fed is now devising new ones, relying on the advice of British journalist Walter Bagehot, author of an 1873 book that central bankers still use as a guide for crisis management.

"The holders of the cash reserve must be ready not only to keep it for their own liabilities, but to advance it most freely for the liabilities of others," Bagehot wrote. "They must lend to merchants, to minor bankers, to 'this man and that man,' whenever the security is good."

Congress and the Treasury have made possible a new generation of loan programs by extending nearly $450 billion to cover losses the Fed might sustain in its lending programs. The Fed relied on $185 billion in additional support from the Treasury in launching the programs announced Thursday.

That leaves the Fed with a significant amount of resources available still to expand these programs or introduce new ones should they be needed. Mr. Powell signaled the central bank was in no hurry to withdraw its crisis support and deflected worries that the expansion of credit by the Fed would lead to inflation.

"I worry that in hindsight, you will see that we could have done things differently. But one thing I don't worry about is inflation right now," he said.

The steps unveiled Thursday will finance loans that banks make through the government's emergency small-business lending program and allow banks to exclude those loans from required capital ratios, freeing them up to make more of those loans, which are separately guaranteed by the Small Business Administration.

The Fed will create two other facilities to encourage banks to lend to midsize businesses, which it defined as those with fewer than 10,000 employees or less than $2.5 billion in revenues last year.

This Main Street Lending Program will enable up to $600 billion in lending to firms that are too large to qualify for the small-business loans but too small to access corporate debt markets. Firms can apply for those loans on top of the forgivable payroll loans from the SBA, and banks will be able to sell 95% of the debt to the Fed.

Due to restrictions placed by Congress, the Fed said loans under the Main Street program would be subject to rules on payments to shareholders and executive compensation.

The Fed earlier announced plans to backstop funding markets for large companies and said Thursday it would expand those programs to accept some riskier classes of corporate debt beyond investment grade.

One corporate credit backstop to support new debt issuance of highly rated firms will now include so-called fallen angels that were investment-grade in mid-March but have subsequently been downgraded. A second corporate credit backstop will similarly allow a limited amount of purchases of non-investment-grade debt in exchange-traded funds.

By dipping a toe into the junk-bond market, the Fed is trying to create space for inevitable downgrades for firms in its lending facilities, reducing the "cliff effect" that companies face when they move from the lower rungs of investment grade to noninvestment grade.

Prices for debt from companies, including Ford Motor Co., registered especially large gains after the Fed's announcement. Ford's 7.45% bonds due in 2031 traded as high as 89.5 cents on the dollar after the Fed's announcement, according to MarketAxess, compared with 71 cents Wednesday. The auto maker has more than $36 billion in bonds outstanding, making it the single largest issuer of below-investment-grade debt.

Other potential beneficiaries include Continental Resources Inc. and Western Midstream Operating LP, which lost their investment-grade status after March 22, the Fed's cutoff date for formerly investment-grade firms. Continental Resources' 4.9% bonds due in 2044 climbed to 73.375 cents from 61 cents.

Another program will accept new classes of debt in the previously announced Term Asset-Backed Securities Loan Facility, or TALF, that were initially excluded from that facility when it was used after the 2008 financial crisis to support consumer and business credit markets. The program will become open to the highest-rated tranches of existing commercial mortgage-backed securities and newly issued collateralized loan obligations.

Under TALF, the Fed lends money to investors to buy securities backed by credit-card loans and other consumer debt. The Fed has made $100 billion available for that program and didn't increase the amount Thursday.

To ease funding strains for cities and states experiencing large revenue drops and rising expenses from simultaneous economic and health crises, the Fed said it would purchase up to $500 billion in short-term debt directly from U.S. states, the District of Columbia, counties with at least two million residents, and cities with at least one million residents.

The facility is designed to provide financing of up to two years to state and local governments dealing with increased demand for services at a time when revenues are plunging. The Fed program aims to restore more buying and selling in a market that seized up in mid-March, causing cities and states around the country to cancel borrowing deals for core infrastructure needs.

Muni-bond prices tanked amid frenzied selling last month. Investors yanked $32.8 billion from municipal-bond mutual and exchange-traded funds, the largest monthly outflows since data collection began in 1992, according to Refinitiv.

By limiting the facility to one issuer for each state, city or county, the Fed is likely to avoid propping up some of the most risky municipal borrowing.

Roughly 10% of muni bonds outstanding are junk-rated or unrated debt, much of it issued with state, city or county permission by a range of private entities including nursing homes and charter schools. Those bonds, many of which are held by high-yield mutual funds or other institutional investors, make up one of the most troubled sections of the market.

Analysts said the Fed's help, while valuable, wouldn't replace the need for more aid from the federal government, which provided around $200 billion to states and cities in last month's stimulus bill.

Unlike the federal government, most states operate with balanced-budget requirements that don't allow them to run deficits. "No amount of borrowing can substitute for actual funding to states that will face really impossible decisions around the provision of essential services, unless Congress alleviates the pressure on state budgets," said Mr. Weiss of the Kennedy School.

During his two years as Fed chairman, Mr. Powell has delicately resisted providing pointed advice about tax and spending decisions outside the central bank's traditional purview of regulating banks and setting short-term interest rates.

While he said the Fed would continue to use its powers "forcefully, proactive and aggressively," he issued a more assertive call Thursday for additional spending from Congress and the White House.

Many borrowers will benefit from the Fed's emergency loans, Mr. Powell said, but "there will also be entities of various kinds that need direct fiscal support rather than a loan they would struggle to repay."

Mr. Powell punctuated his call for additional fiscal support by highlighting how severe economic burdens are falling on low-income workers and other vulnerable segments of society.

The task of delivering financial support "directly to those most affected falls to elected officials, who use their powers of taxation and spending to make decisions about where we, as a society, should direct our collective resources," Mr. Powell said.

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By Nick Timiraos

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