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Daily Deck: Trade-off between pain and recovery

Yes the Fed was aggressive last night. But they are not done. Moreover, we maintain, there is a lack of appreciation for some of the fiscal policies that were already floated. This point should not be lost in the noise. Help to the small business community is critical. Overall, we maintain our view that most of the authorities are basically doing the right thing, and once we get beyond the ugly ding to growth that is coming, policies in place should allow for growth to start the process of healing in the second half.

Another major theme evolving over the weekend is that more aggressive social distancing measures have caused many to downgrade 2Q growth expectations sharply. Shutting down schools, limiting crowd sizes, shutting down travel in a big way, closing restaurants, implementing curfews, and more aggressive self-imposed social distancing could indeed exacerbate the near-term pain. **But critically, more aggressive social distancing also means a shorter span between now and when we turn the corner on COVID-19.** In other words, we compress both the pain and the turnaround time into a shorter window. At the extreme, given what we know about the virus, shutting all social contact down for two weeks would eliminate further transmission. **To the degree with which we do social distancing, as that approaches the extreme, so too does the timeframe for when we get a handle on this crisis.**

The Fed Cannon: In one of our many phone calls last night we asked someone what is bigger than a bazooka and we were told a cannon. So be it. That is what the Fed used last night. The Fed went all-in in terms of the tools (currently) at its disposal, cutting rates to the lower bound of 0.00/0.25%, dropping the discount window rate by 150bps to 0.25%, ramping up QE to at least $500b in Treasuries and $200b in MBS on net (run-off is over), and providing significant support via large repo operations and FX swap lines. That's all great. Fortunately, the banking system is healthy and well capitalized and should provide a good conduit with which to deal with the cash crunch. **But the Fed is not done.** As we said last week, the additional asset purchases the Fed promised last week was surely going to be upsized and we will say that again today. Moreover, while the Fed's section 13(3) authority (what was used to help the JPM/Bear acquisition and the authority under which they created many of the "alphabet soup" of programs) has been altered in a post Dodd-Frank world, if liquidity in various markets remains an issue, we will see a resurrection here.

We also want to make sure a point is not lost: **the Fed is providing support above and beyond a multi-week window. These policies are likely to remain in place through the foreseeable future.** Indeed, even if we get a significant ebb in the virus towards the end of 2Q, policy will remain very easy for a long time. The risk of a second wave of COVID-19 starting in the fall flu season will be top of mind even if the virus quiets down in the summer. Thus, even with a substantial rebound in economic activity in 3Q and early 4Q, the Fed will be hard-pressed to "take back" any of the policy easing initiatives. Expect zero rates and ongoing QE until after 2Q21 at the earliest as this is when we will have some certainty on the prospects of a second wave of COVID-19.

A $50b SBA emergency lending facility: Last week we highlighted that we were impressed by the SBA loan announcement. Here is some additional context. All nonfarm proprietors'

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income in the United States is about $1.7 trillion annualized. **Thus, the SBA facility can theoretically cover a 20% loss in business over a 2-month span. This would be unprecedented in the post-war era.** The largest 3-month point-to-point drop in this space since the 1960s was a near-8% decline in 1981 (on the back of heavy contractionary policy by the inflation fighting Fed). This space was down a bit more than 14% peak-to-trough during the financial crisis.

Postponing April 15th tax deadline: The pushback on this is that the April 15th deadline is only relevant if you owe taxes and thus most wage earners will not benefit from this provision. Yes that is true, **but this is not about individuals. It is entirely about small businesses. It would act as a "bridge loan" to many small and medium sized companies.** Many of these firms file taxes as "individual" returns. Note that non-withheld tax receipts to the Treasury totaled about $200 billion in April of last year. If we are indeed contending with a multi-month shock, postponing tax payment until mid-June (as has been proposed on a bi-partisan way) could provide ample relief here.

Short-term unemployment: Dealing with the cash crunch can help stave off a significant jump in short-term unemployment. Recall that ahead of the virus emerging, the US labor market was extremely tight with more than 1 opening per officially unemployed person. If the baseline view is that this is a storm that needs to be weathered for about 8 weeks or so then the impetus to lay off workers should be lessened – especially if firms have the cash flow/liquidity to get through the crunch. Anything more significant in terms of timing/evolution of the crisis would bring about a more protracted unemployment environment and likely strain state budgets that provide unemployment insurance for about 26 weeks.

Economy is not "hibernating": One area of clarity in coming weeks and well before we have any good information on the evolution of the virus is just how businesses will adapt to this new reality. We know the travel industry is in dire straits because of social separation, but there have been plenty of reports that bailouts are in the works in DC for this sector. Other heavily impacted industries, like restaurants, are already coming up with innovative ways to keep some business going. In the wake of the "hunkering down" many restaurants have begun to offer curbside pickup and many restaurant delivery services are offering "no contact" drop-off. For other spending in general, it seems (given increased delivery timelines) that online retail has never been busier. **We think while there is a heavy impetus to write off those areas of the economy that are heavily impacted by social separation, there is little credence given to the potential offsets via increased spending in "stay-at-home" goods and services. The situation naturally leads to one of growing pessimism and "worst-case-scenarios" as becoming the base case. But perhaps we are underestimating the ability of companies to adapt.**

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