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"The COVID-19 Pandemic, the Economic Outlook, and the Main Street Lending Program"

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The views expressed today are my own, not necessarily those of my colleagues on the Federal Reserve Board of Governors or the Federal Open Market Committee.

Good morning. Thank you for inviting me to address the South Shore Chamber of Commerce. While it is unfortunate that we cannot be together for this event, I am grateful that technology allows us to gather virtually.

Public Health and Economic Effects

This continues to be a challenging time, with the high rate of positive COVID-19 cases and resulting deaths across the country highlighting the unfolding human tragedy of the pandemic. In addition to a tragic loss of life, the pandemic has resulted in an unprecedented shock to the U.S. economy.

The inability, thus far, to control the virus in the United States is resulting in renewed restrictions on individuals and businesses in many parts of the country. While vital and necessary for the good of the economy in the longer run, the ongoing social distancing in response to the virus's spread will continue to complicate policymakers' task of supporting the economy in the short run with fiscal and monetary policy. As the Federal Reserve's July Federal Open Market Committee statement highlighted, "The path of the economy will depend significantly on the course of the virus." [1]

Even as official restrictions relax, many people may prefer to continue avoiding activities that require social interaction in order to protect their own health. With such a pattern of behavior taking hold, momentum in the economy toward returning quickly to full employment would likely fade. Being cautious during a pandemic is absolutely the right thing to do, and all of this highlights that we must get the virus under control in order for a sustainable economic recovery to take hold.

The New England region currently has COVID-19 infection rates below those prevailing in many parts of the country, including the South and the West. Recently, however, New England infection numbers have been gradually increasing. Certainly, common sense precautions – such as wearing masks when around other people, maintaining safe social distance, and avoiding crowded indoor settings – are much less costly than having to shut down whole sectors of the economy again. It is, therefore, important that everyone continue to take steps to protect public health in order to avoid more tragic outcomes along with further economic pain. This is especially true at a time when some colleges and universities are resuming in-person classes, and some K-12 school districts are planning to bring students back together this fall – when there will be less ability to congregate outdoors.

Today I would like to begin my remarks by reviewing the current state of the U.S. economy, and I will then discuss some of the steps that the Fed is taking to address the crisis and mitigate its impacts on both financial markets and the real economic activity of American households and businesses.

In this crisis, which finds little precedent in our lifetimes, both monetary and fiscal policymakers have moved aggressively to offset some of the economic impact of the pandemic. Policy actions this year have been large and timely, reflecting the urgency of the risks that the continuing public health crisis poses. Specifically, the federal government has expanded its usual programs to help individuals during a downturn, such as making unemployment benefits more widely available and increasing the payouts, as well as providing direct payments to lower-income individuals. Keeping this segment of the economy afloat, by providing a financial bridge until economic conditions normalize, will play an important role in the recovery.[2]

In addition, one of the segments of the economy heavily impacted by the pandemic has been small and medium-sized businesses, which together employ a very sizable share of the workforce. Many small and medium-sized businesses had to close down operations when quarantine restrictions were put in place in the spring and simply cannot fully recover until the pandemic has abated.

As one measure to address this concern, in early July the Federal Reserve Bank of Boston, on behalf of the Federal Reserve System, opened the Main Street Lending Program, or MSLP, which aims to help facilitate credit flows that can provide a bridge for small and medium-sized businesses until better economic times arrive. Because activity in the facility will depend, to a significant degree, on the path of the economy and the virus, I expect utilization to increase as we get into the fall. I will say more about this later in my remarks.

Despite the sizeable interventions by monetary and fiscal policymakers, high-frequency economic data indicate that the recovery may be losing steam, as activities in many states are once again restricted (officially or voluntarily) to slow the virus's spread. Particularly in some parts of the South and the West, where some hospitals are reaching their ICU capacity, changes in behavior are showing up in high frequency data on individuals' mobility and spending. Clearly, continued stimulative monetary and fiscal policy are critical, and most importantly slowing down the COVID-19 infection rate.

The Outlook for the Economy

A notable feature of this recession is how aggressively policymakers have responded. **Figure 1** shows the path of real disposable personal income since January 2000. Generally, the data fall on a relatively consistent line, and you see relatively small changes around the periods of recession shading. However, in this recession, there has been a substantial increase in real disposable income. This reflects the extraordinary amount of fiscal action taken to offset the impact of the virus. Fiscal policy has provided many individuals with substantial financial support, as befits an unprecedented crisis.

The extraordinary fiscal relief provided to households, however, has translated only modestly into spending. **Figure 2** shows a striking rise in the personal saving rate – a far bigger jump than we have seen at any time since World War II. Several factors account for this surge in saving. First, with both required and voluntary social distancing, and less willingness or ability of many people to pursue certain activities – such as travelling, attending entertainment events with crowds, or eating indoors at restaurants – spending will likely be lower relative to the past, until activities involving social interaction entail substantially less public health risks. Second, saving may have risen for some because of the concern about the prospects for worse economic circumstances and less fiscal support going forward. In all, the increase in saving is a reminder of the importance of containing the pandemic in order to achieve a more robust recovery.

Along with fiscal policy, monetary policy reacted quickly and decisively. Short-term interest rates were quickly dropped to close to zero in March and, as **Figure 3** shows, the 10-year Treasury yield is well below the level reached during the financial crisis of 2008-9 and Great Recession. In addition, the Fed has deployed a variety of emergency credit facilities designed to maintain the availability of credit to firms and individuals. Based on many decades of research and policymaking, I can attest that credit interruptions prolong recessions and ultimately harm individuals and firms on "main streets" across America.[3] So these credit facilities implemented by the central bank are very important, and welcome.

With such substantial deployment of fiscal and monetary policies, one might expect a robust recovery. Unfortunately, as long as the virus poses significant threats to public health, a full economic recovery will be very difficult as individuals, often voluntarily, avoid activities that place their health at risk. The increased saving rate, reflecting a falloff in consumption despite substantial fiscal transfers to individuals, illustrates the challenges the recovery faces. Indeed, the trajectory of the economic recovery will be determined more by the path of the virus than by the path of policymaking, although monetary and fiscal policy can mitigate, and have mitigated, some of the most significant adverse impacts to the economy.

Recent Data, and the Pandemic's Effect on the Economy

Figure 4 illustrates one of the challenges in achieving a full, and timely, economic recovery by comparing new COVID-19 cases per million in the European Union with those in the United States. While both the EU, which I'll refer to here as Europe, and the United States had significant increases in infection rates during the spring, Europe enacted more stringent economic shutdowns and limits on individuals' mobility that were maintained over a longer period. As a result, their infection rates fell faster and further, and have remained relatively low. In contrast, in the United States, infection rates remain elevated, as states lifted protective measures too soon and in a manner not calibrated for the true risks posed by the virus. For the country as a whole, the infection rate is much higher than in the spring, and stands in sharp contrast to the level of infections in Europe.

Figure 5 compares new COVID-19 death rates in the United States and the European Union. The chart shows that deaths per million in population have been rising and are considerably higher in the U.S. than in Europe. The U.S. death rate from the virus remains below its peak in the spring – in part, many suspect, because younger patients have accounted for more of the infections, and also because hospital treatments have improved. Nonetheless, the rising death rate could become more severe if infections that start with younger people spread to more vulnerable individuals over time.

Figure 6 shows cumulative deaths per million people from the virus in Europe and the United States. While Europe had more cumulative deaths than the U.S. through March and April, cumulative deaths in the United States have now far surpassed those in Europe. The reason, I would argue, is highlighted in **Figure 7,** which shows the change in visits to retail and recreational locations in the U.S. and select countries in Europe. The pattern of the visits illustrates how Europe shut down more forcefully, maintained restrictions longer, and did not re-open until the virus had reached low levels. As a result of this more successful virus containment policy, visits by Europeans to retail and recreation locations have now experienced a more robust recovery compared with American visits to such locations and are close to their pre-pandemic levels.

Additional evidence of the costs of early re-opening of the U.S. economy – in economic and public health terms – can be seen in data on infections, mobility and consumer spending across states, as highlighted in my next four charts. They demonstrate various facets of the interactions between the virus and the economy.

Figure 8 plots the states based on two factors – first, the level of mobility within each state (as measured by cellphones coming in close proximity to one another) at the end of May and beginning of June, relative to February (pre-pandemic); and second by the change in the types of spending that are sensitive to social distancing, in May versus April. Spending that is sensitive to social distancing involves sectors such as travel, hotels, restaurants, and certain personal care services like beauty salons and barber shops. What we see is evidence of the *initial* economic benefit in states that became less restrictive earlier. The regression line shows the correlation – spending in May was stronger, relative to pre-pandemic levels, in those states that had more mobility (contacts) and less restrictions on economic activity.

But, unfortunately, that benefit was short-lived.

Figure 9 compares the same mobility measure for each state to the percentage change in infections in July. The regression line highlights the overall relationship – more mobility in a state through June is generally correlated with larger recent increases in infection rates in July. In particular, states in the Northeast typically experienced much less mobility through June, but also much lower growth in infections in July than many states in the South and West.

The lower recent growth in infections in some states is in turn associated with greater *recent* mobility. **Figure 10** compares the percent change in COVID-19 infections in July with the change in mobility (contacts) in the same period. The Northeastern states now have smaller increases in infections and higher mobility, as lower infection rates support more mobility. In contrast, Southern and Western states now have more infections and less mobility, as people reduce contacts both voluntarily and because of increased restrictions on economic activity.

Finally, **Figure 11** shows that the monthly growth rate in July spending was ultimately much better in the previously more restrictive and slower to reopen states in the Northeast relative to many Southern and Western states. Specifically, the figure plots the change in COVID-19 cases in July versus the change in social-distancing-sensitive spending in July.

Taken together, these data show that states that re-opened early and quickly lifted restrictions saw a short-term increase in activity, but it was at a cost – rising rates of infections, which resulted in less spending more recently. In short, lifting restrictions too early and too quickly hurt both the economy and public health down the road. In the Northeast, where restrictions were more substantial and lasted longer, states are now experiencing both better public health outcomes and more spending in sectors of the economy that are sensitive to social distancing. These results are somewhat parallel to the differences in outcomes between Europe and the U.S.

Despite some states achieving a recent reprieve from COVID-19 infections, it is of course important to remain vigilant, given the ease of spread of the virus due to the ease of travel across state borders. Recent slight upticks in states like Massachusetts and countries like Germany – which have taken the pandemic seriously – bear watching. Going forward, states should be carefully calibrating their actions to data, especially as we reach the fall with schools opening and more activities moving inside as the seasons change. Failure to take quick actions to suppress the virus could result in more severe economic outcomes as well as the unnecessary loss of life.

An Update on the Main Street Lending Program

As I noted earlier, the path of the economy depends heavily on the path of the virus. No economic policy action can fully offset the public health crisis, but it can help limit its impact on the economy.

An important economic policy action designed to mitigate current and potential economic effects of the pandemic is the Main Street Lending Program, which seeks to facilitate the continued flow of credit to small and medium-sized businesses that were in sound financial condition prior to the pandemic, but have been adversely impacted by it. The program is attractively structured for many businesses facing cash-flow interruptions due to the pandemic by facilitating 5-year loans with no payment of interest in the first year and no payment of principal until the third year. It is attractive for lenders because they can meet the credit needs of credit-worthy companies and nonprofit organizations in their markets while retaining only 5 percent of the loan on their books, with the Federal Reserve taking a 95 percent participation interest in the loan.

With the program, the Fed is aiming to help creditworthy businesses and nonprofits that have suffered temporary cash-flow problems due to the pandemic, and, given the uncertain outlook, might otherwise have difficulty in obtaining credit from a lender that would have to hold 100 percent of the loan. The Main Street program can provide essential financing to help these entities avoid shutting their doors and permanently laying off their employees.

Figure 12 shows that there are currently 522 lenders registered in the program. Banks of all sizes have enrolled, with the greatest number of banks in the $1-10 billion range, although smaller community banks and larger universal banks have also signed up.

One concern raised by potential borrowers about the program was that their bank might not be participating in the program and, if that were the case, how could they find a bank willing to take on a new customer and work with them on a Main Street loan. In response, we have made available an interactive map on our website, www.bostonfed.org/mslp, which provides a list of all participating banks in each state that are currently accepting loan applications from new customers and that have agreed to be announced to the public. There are currently 160 banks on this list; **Figure 13** provides a view of the banks in Massachusetts that are part of this subset of registered lenders.

By the way, while participation on any level in the MSLP is voluntary – registering, working with existing customers, or taking on new customers – I strongly encourage additional banks to consider joining those already registered and those on our list accepting new customers. We have seen tremendous interest from potential borrowers experiencing a pandemic-related, temporary disruption of their businesses. Financial institutions have a vested interest in the continued viability of local businesses and organizations, and the vibrancy of their local economy. The Fed is eager to work with lenders and help them as they provide credit to their borrowers. Given the unprecedented crisis brought on by the pandemic, it is important that the Federal Reserve take extraordinary measures to help "main street" businesses.

Importantly, additional debt may not be right for every business and organization at this challenging time, but I would encourage businesses that have been disrupted by the pandemic and are in need of financing to explore the program. On the Boston Fed's website, at www.bostonfed.org/mslp, you can learn more about the terms and conditions of the program, inquire with banks in your network to see if they are participating, and if not consult the interactive map for lenders in your state accepting applications for new customers.

For many, the program can serve as a vital bridge to address cash flow interruption ushered in by the pandemic. Of course, bank loans are contracts between borrowers and banks, and the negotiations for loans can take some time and effort. As a result, when the program was launched in early July, there were relatively few Main Street program loans submitted for participation purchase. As borrowers and banks have become more familiar with the program, we have seen a steady increase in banks submitting loans to our portal.

Figure 14 shows that there are currently more than $856 million in loans active in the portal, with more than $250 million in loans committed or settled. Much of the increase has occurred recently, and I expect we will continue to see more activity as more firms are impacted by the pandemic. Unfortunately, should the fall bring a resurgence of the virus as many epidemiological models predict, this program may become even more essential.

Some seem eager to suggest that the Main Street program's modest initial activity is evidence of failure. I completely disagree, and allow me to explain why.

The Program differs from other programs for businesses made possible by the CARES Act, reflecting the parameters of what the Federal Reserve is authorized by Congress to do. Unlike the Paycheck Protection Program, where many loans could turn into *grants* funded by the CARES Act, the Main Street program involves loans that must be repaid. These loans are negotiated between the borrower and lender, designed to meet the special needs or circumstances of a particular borrower, and must be underwritten by the lender. A grant program, or a lending program with even more generous terms, would of course have faster uptake. But MSLP's design, as determined by the Federal Reserve Board in Washington, in conjunction with the

Treasury, can indeed support the flow of vital credit to many firms and nonprofit organizations. The Federal Reserve and Treasury have sought to design a program that is well managed with respect to risks, efficiency, and resilience, while being responsive to the needs of borrowers experiencing difficult times.

Indeed, designing and operationalizing a program of this breadth and nuance, delivered through secure technology, is a significant achievement in a few months' time. Everyone involved is focused on the public service goal of helping to provide important credit support to businesses and nonprofits at this critical and challenging period. Quickly scaling up a program that purchases a large portion of existing loans – from a very diverse group of borrowers in a decentralized market that lacks standardization – is inherently difficult. There are also tradeoffs between limiting credit risk, ensuring that operations are safe and secure, reaching scale, and achieving operational efficiency.

As a reminder, the program opened for loan purchases on July 6. The numbers to date seem to me consistent with what I would characterize as a gradual pace of initial activity that is more recently expanding as participants become familiar with the program's parameters.

It is important that the Federal Reserve stands ready at this time of distress, in the public interest and in pursuit of our Congressional mandates, to facilitate lending to for-profit businesses and nonprofit organizations of many sizes at reasonable rates. As I mentioned at the outset, credit interruptions prolong recessions and ultimately harm individuals and businesses on main streets across America. The Boston Fed and the Federal Reserve as a whole see the Main Street Lending Program as one way to do all we can to support the businesses, nonprofits, and individuals that make up our nation's economy.

Concluding Observations

Unfortunately, the economic outlook is being driven by the course of the pandemic, and much depends on how successfully it can be contained, either through public health or medical innovations. The forecast for the U.S. economy this fall is quite uncertain, but my view is that the recent slowdown in economic activity that we have seen in high frequency data is likely to continue. Currently, we have an unemployment rate above 10 percent, and because of the continued community spread of the virus, I am concerned that the pandemic will limit the ability of the economy to recover quickly. As a result, an increasing number of those who are currently temporarily unemployed may ultimately have to face permanent layoffs and the difficult task of finding a new job in a changed economic environment.

At the Fed, we are focused on doing all in our power and purview to support the economy, including through efforts we are very proud of, like the Main Street program that again I recommend lenders, businesses, and nonprofits explore participating in.

While the fiscal and monetary stimulus has been significant, it cannot fully offset the economic drain caused by the public health crisis. Limited or inconsistent efforts by states to control the virus based on public health guidance are not only placing citizens at unnecessary risk of severe illness and possible death – but are also likely to prolong the economic downturn.

Thank you for having me today. I wish you all continued good health during these challenging times.

[1] See July 29, 2020 statement of the Federal Open Market Committee: https://www.federalreserve.gov/newsevents/pressreleases/monetary20200729a.htm.

[2] For more discussion, see: https://www.bostonfed.org/news-and-events/speeches/2020/an-update-on-the-economy-and-the-main-street-lending-program.aspx

[3] For additional research on this topic, see https://www.bostonfed.org/people/bank/eric-rosengren.aspx#biography, especially the following work:

- "Credit Supply Disruptions: From Credit Crunches to Financial Crisis" Current Policy Perspectives No. 15-5 with Joe Peek; also in the *Annual Review of Financial Economics*. vol 8, (2016): 81 - 95.
- "The Impact of Liquidity, Securitization, and Banks on the Real Economy." *Journal of Money, Credit and Banking.* vol. 42 (September 2010): 221-228.
- "Identifying the Macroeconomic Effect of Loan Supply Shocks," with Joe Peek and Geoffrey M.B. Tootell. *Journal of Money, Credit, and Banking*. vol. 35, no. 6, part 1 (December 2003): 931-946.
- "Troubled Banks, Impaired Foreign Direct Investment: The Role of Relative Access to Credit," with Michael Klein and Joe Peek. *The American Economic Review*. vol. 92, no. 3 (June 2002): 664-682.
- "The Capital Crunch: Neither a Borrower Nor a Lender Be," with Joe Peek. *Journal of Money, Credit and Banking*. vol. 27, no. 3 (August 1995): 625-638.
- "Bank Regulation and the Credit Crunch," with Joe Peek. *Journal of Banking and Finance*. vol. 19, no. 1 (June 1995): 679-692.
- "Bank Real Estate Lending and the New England Credit Crunch," with Joe Peek. *Journal of the American Real Estate and Urban Economics Association*. vol. 22, no. 1 (Winter 1994): 33-58.