Federal Reserve Bank of Boston®

An Update on the Economy and the Main Street Lending Program

Eric S. Rosengren
President & CEO
Federal Reserve Bank of Boston

Remarks to the Greater Providence Chamber of Commerce

June 19, 2020

Introduction

- Focus on the effects of the pandemic on the economy, the implications for Fed policymaking, and steps to address the crisis and mitigate its financial impact on American households and businesses
- This includes the establishment of the Main Street Lending Program
  - Program opened for lender registrations on Monday of this week
  - Building it and its operational background has been a complicated undertaking
  - Confident it can help lenders across the country support the credit needs of local businesses during these very challenging economic times
  - Fed is standing ready to purchase 95 percent of eligible program loans – loans with terms to bridge businesses to better days, like a 5-year term and no principal payments for the first two years

Pandemic and the Economy

- Providence and Boston experienced significant challenges from the virus
  - As with many cities with great histories, they are attractive tourist and business travel sites
  - Both cities are transportation and education hubs
  - Data-focused strategy for relaxing quarantine arrangements is paying dividends for the health of individuals as well as the economy
- Shutdown was essential but costly
  - Avoid overwhelmed healthcare systems
  - Allow safety protocols to be established

Employment Situation

- May employment was more positive than expected
  - Return to work is good news – if done safely and on a sustained basis
  - If workplaces reopen without necessary health precautions, risk undermining investor, consumer, and firm confidence
- Impact of pandemic falls disproportionately
  - Personal services – restaurants, hotels, retail stores, tourism
  - Workers in those industries – frequently people of color, young workers, workers with less educational attainment

Policymakers Have Acted Quickly

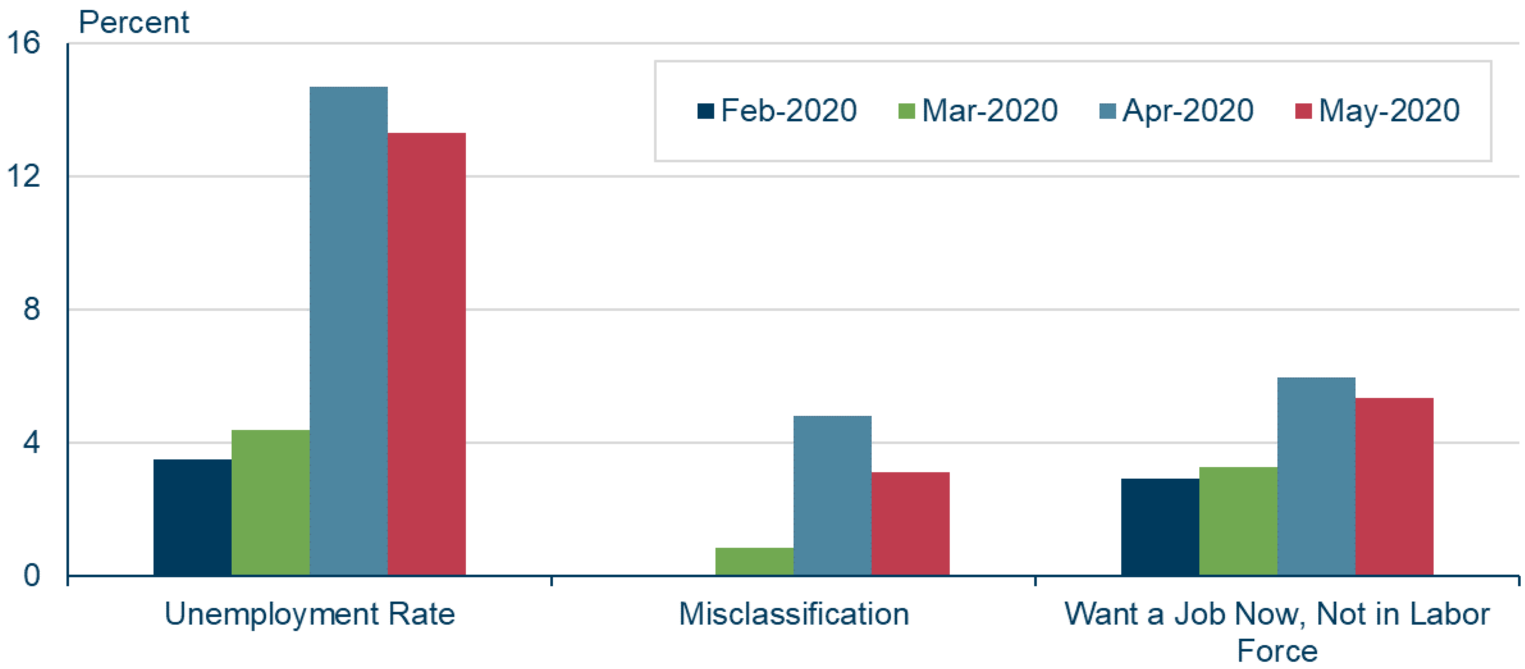
- Federal government – direct and indirect payments to individuals
- Federal Reserve
  - Lowered short-term interest rates to essentially zero
  - Purchased Treasury and mortgage-backed securities
  - Started emergency lending facilities
- More policy actions needed
  - Unemployment is too high, inflation is too low
  - My own forecast is tempered by continued community spread of disease
  - Economic rebound faces headwinds and I expect unemployment at the end of the year to still be in double digits

Data Interpretation Difficult

- Spending and employment data: mix of mandatory shutdown and more persistent economic weakness
- Unemployment in May – 13.3 percent
  - Misclassification according to BLS would add just over 3 percent
  - Individuals leaving the labor force has increased
  - Labor market badly disrupted

Figure 1: Labor Market Conditions

February 2020 - May 2020

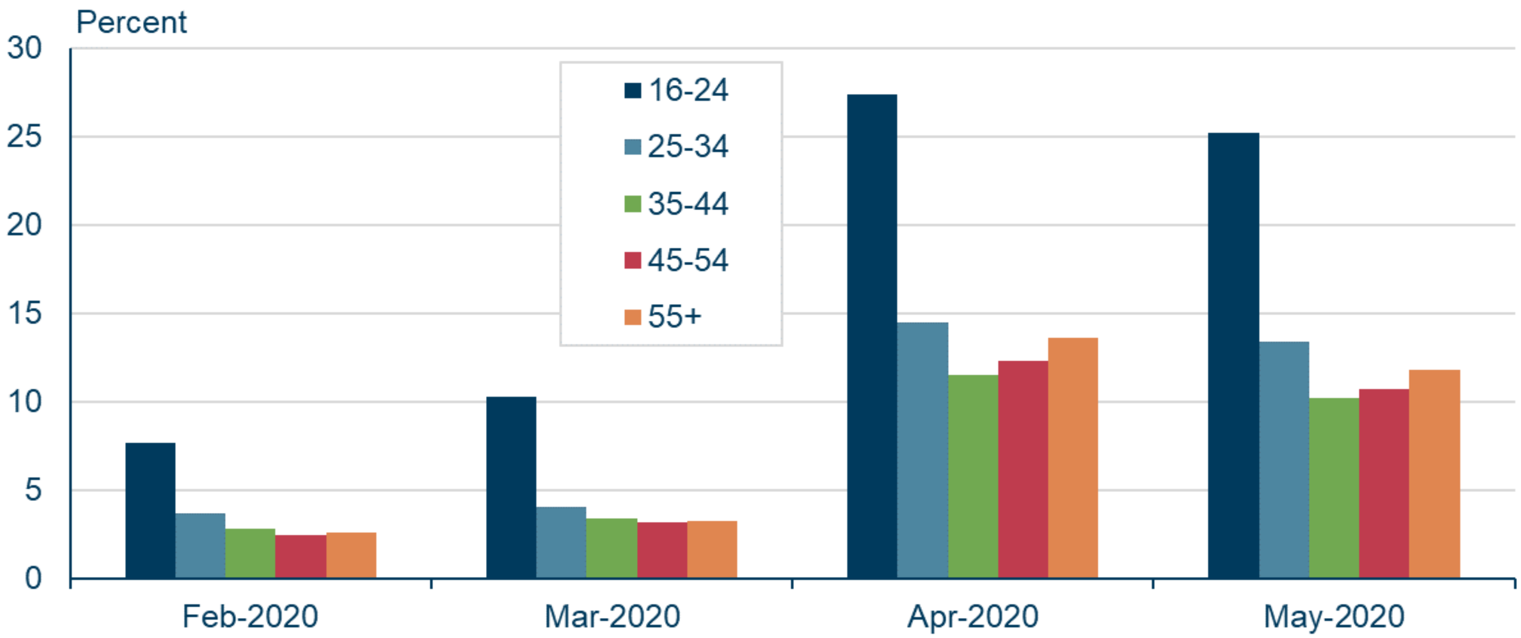


People who did not work during the reference week due to efforts to contain the spread of the coronavirus should have been classified as "unemployed on temporary layoff." However, some were classified as "employed but not at work" and were not counted as unemployed. The misclassification bars are the BLS estimates of that misclassification and could be added to the unemployment rate. For the "want-a-job-now" calculation, the denominator – the labor force – is expanded to include the "want-a-job-now" group.

Source: BLS, Haver Analytics

Figure 2: Unemployment Rate by Age

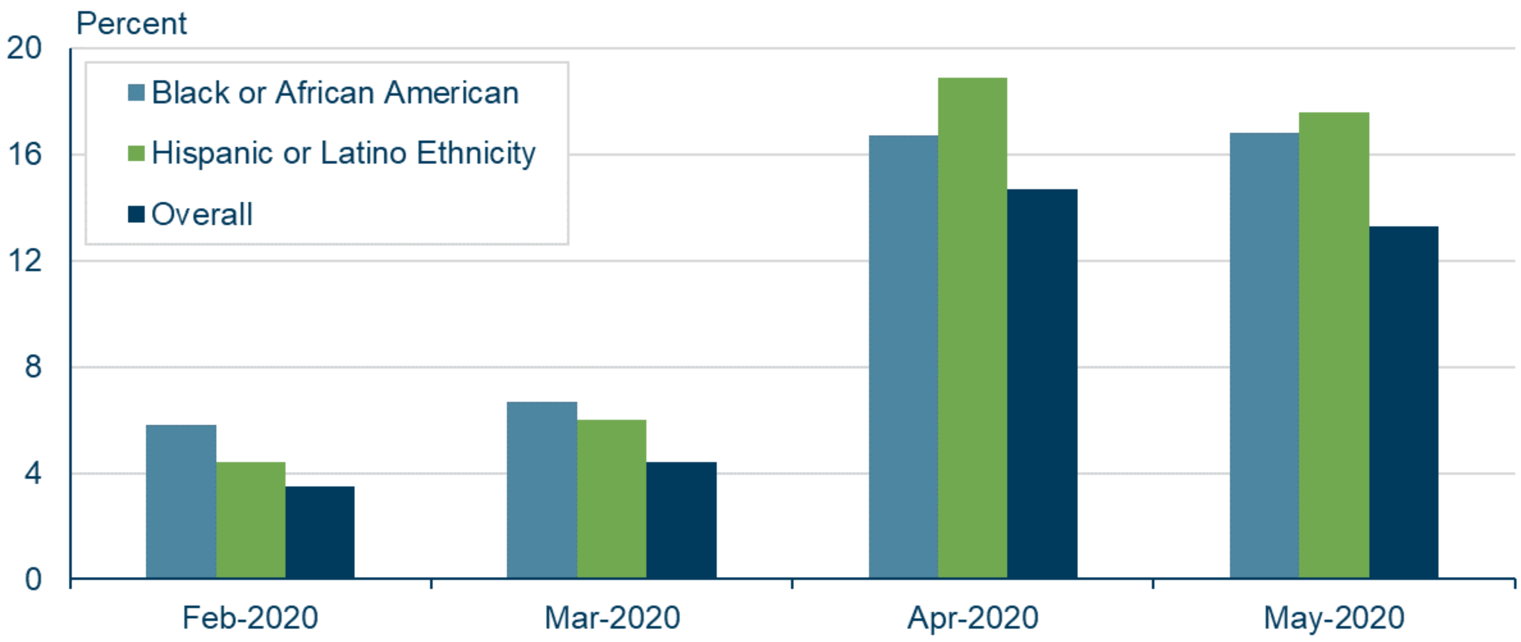
February 2020 - May 2020



Source: BLS, Haver Analytics

Figure 3: Unemployment Rate by Race and Ethnicity

February 2020 - May 2020

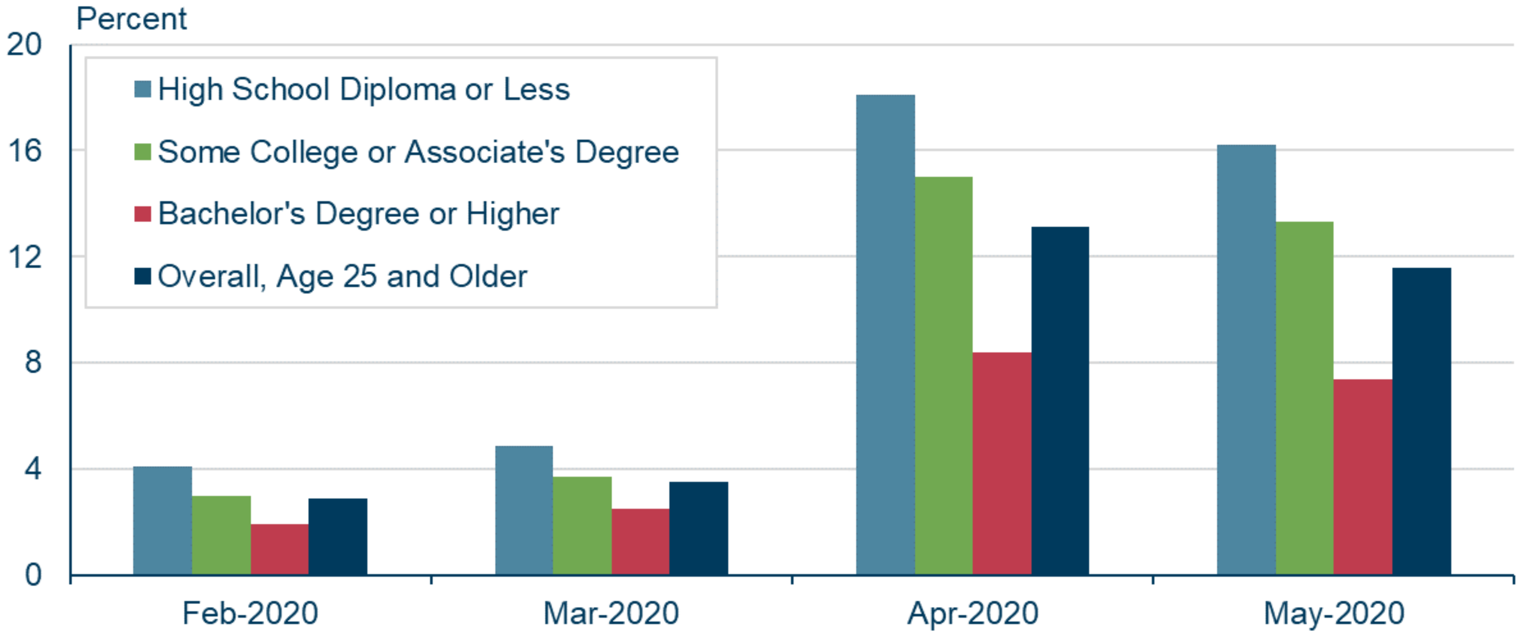


Note: Based on labor force age 16 and older. Persons whose ethnicity is identified as Hispanic or Latino may be of any race.

Source: BLS, Haver Analytics

Figure 4: Unemployment Rate by Educational Attainment

February 2020 - May 2020



Note: Based on labor force age 25 and older.

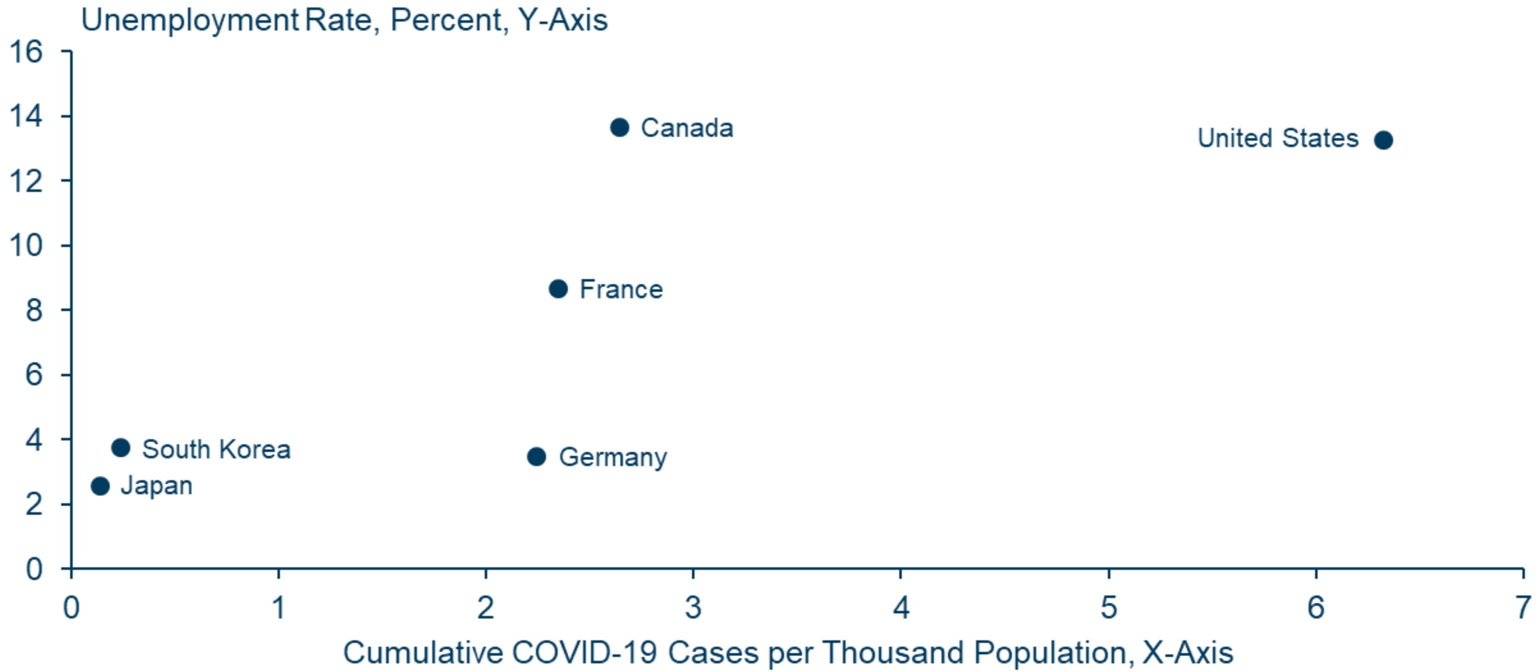
Source: BLS, Haver Analytics

Figure 5: Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents for 2020 and 2021

Summary of Economic Projections	Median Forecast for 2020	Median Forecast for 2021
Real GDP Growth (%, Fourth Quarter Change from Previous Fourth Quarter)	-6.5	5.0
Unemployment Rate (%, Fourth Quarter)	9.3	6.5
PCE Inflation (%, Fourth Quarter Change from Previous Fourth Quarter)	0.8	1.6
Core PCE Inflation (%, Fourth Quarter Change from Previous Fourth Quarter)	1.0	1.5

Source: FOMC, Summary of Economic Projections, June 10, 2020

Figure 6: COVID-19 Cases vs the Unemployment Rate

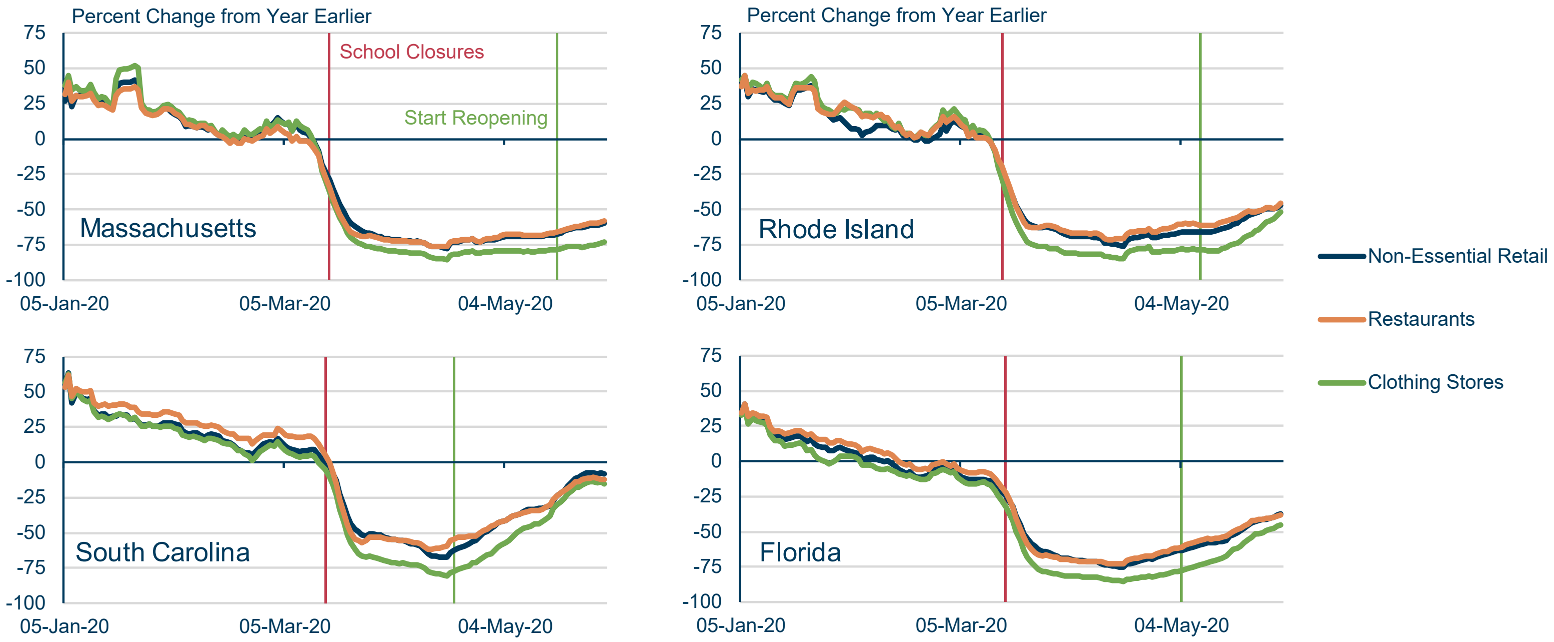


Note: All unemployment rates are for April 2020 except for the unemployment rates for the U.S. and Canada which are for May 2020. Cumulative COVID-19 cases are as of June 16, 2020.

Source: BLS, OECD, United Nations, WHO, Haver Analytics

Figure 7: Visits to Restaurants and Stores

January 5, 2020 - May 31, 2020

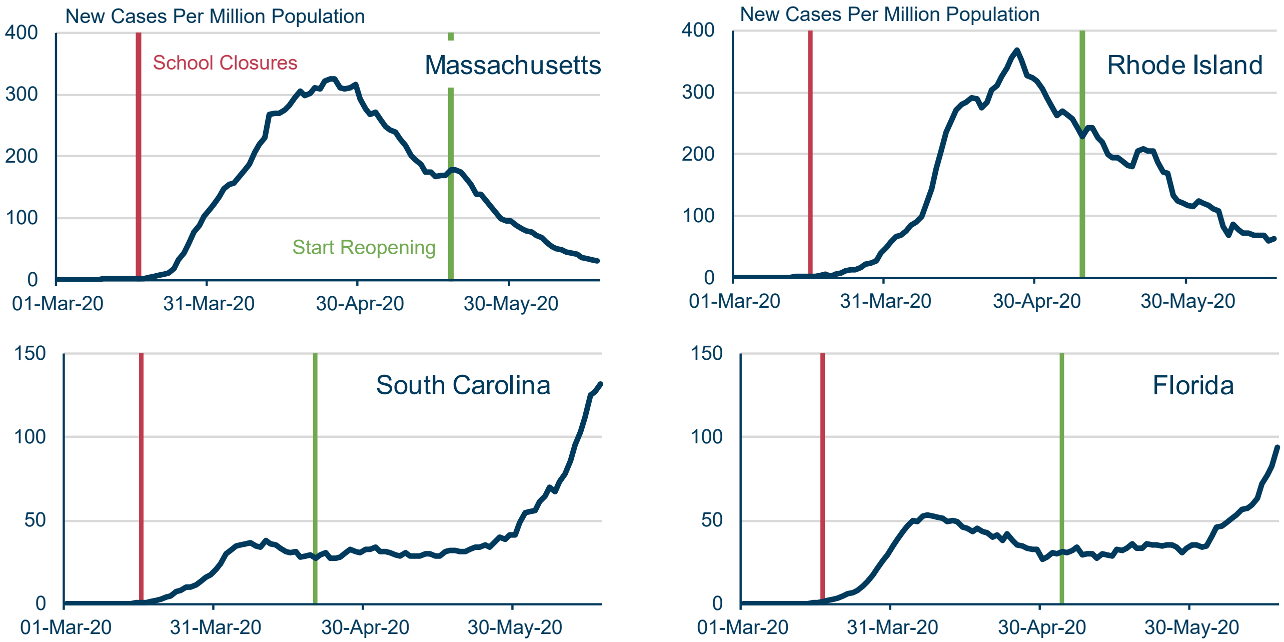


Note: Visits are seven-day moving averages.

Source: SafeGraph Patterns

Figure 8: New COVID-19 Cases Per Million Population

March 1, 2020 - June 16, 2020



Note: New cases are seven-day moving averages.

Source: Massachusetts Department of Public Health, Johns Hopkins University, New York Times

Risks to the Outlook

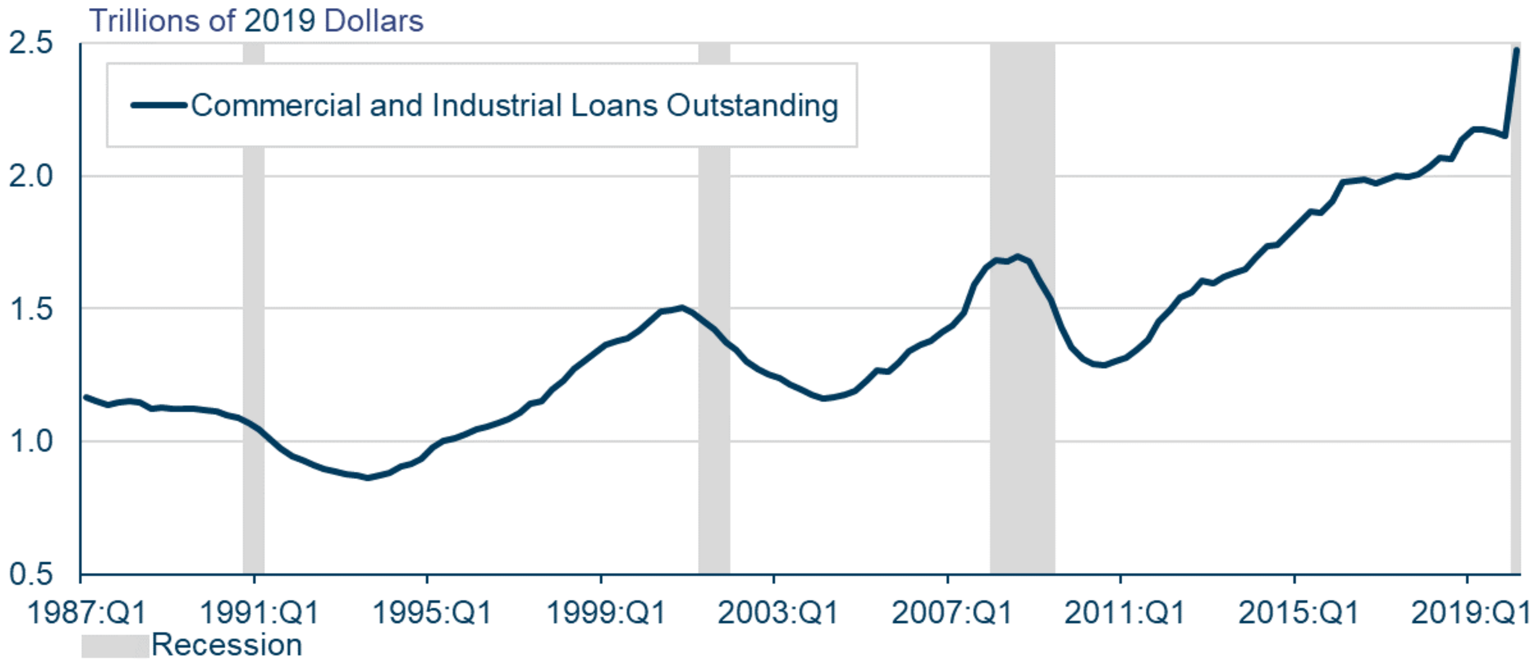
- Substantial risk in reopening too fast and relaxing social distancing too much
- 1918 Spanish Flu, 1957-1958 Asian Flu and 2009-2010 H1N1 Flu had more severe second wave
- More pessimistic than median FOMC participants that this will be continued challenge in second half of year
- Even if more optimistic than my forecast, need stimulative monetary policy

Main Street Lending Program

- Aims to help facilitate credit flows that can bridge small and medium-sized businesses until better economic times
- Focuses on bank loans to businesses
- Since every business, and every business loan, is somewhat unique, the program is inherently complex

Figure 9: Business Lending at Commercial Banks

1987:Q1 - 2020:Q1



Note: Commercial and industrial loans outstanding are adjusted for inflation using the GDP Deflator.

Source: Commercial Bank Quarterly Call Reports, BEA, NBER, Haver Analytics

Importance of Main Street Lending Program

- While previous recessions have involved credit crunches, the kind of shock we’ve seen since the pandemic arrived is unprecedented
  - Banks concerned about worsening economic conditions
  - Reluctant to lend into possible second wave
  - Banks constrained by possible future bank capital challenges
- The Fed will participate in the lending by purchasing a 95 percent interest in each eligible loan
  - Federal Reserve will take on most of the risk that would otherwise need to be absorbed solely by lenders
  - Will create additional balance sheet capacity for lenders to extend more loans at this challenging time

Summary of Major Adjustments to Main Street Lending Program Term Sheet

- Main Street Lending Program terms have been made more attractive
- Lowering the minimum loan size for certain loans to $250,000 from $500,000
- Increasing the maximum loan size for all facilities
- Increasing the term of each loan option to five years, from four years
- Extending the repayment period for all loans by delaying principal payments for two years, rather than one; and
- Raising the Reserve Bank's participation to 95 percent for all loans

Figure 10: Main Street Lending Program: Proposed Term Sheet for Nonprofit Organizations

	Nonprofit Organization New Loan Facility	Nonprofit Organization Expanded Loan Facility
Loan Term	5 Years	
Principal Payments	Deferred for two years. Years 3-5: 15%, 15%, 70%	
Interest Payments	Deferred for one year	
Interest Rate	Adjustable rate of LIBOR (1 or 3 month) + 300 basis points	
Loan Size	$250,000 - $35 million	$10 - $300 million
Lender Participation Rate	5%	
Prepayment Allowed	Yes, without penalty	

Note: The Federal Reserve and the U.S. Department of the Treasury are seeking comment on the two facilities designed to support nonprofit organizations. Comments will be accepted through June 22, 2020 via this form.

Source: Federal Reserve Board

Lender Registration Update

- Over 200 financial institutions - large and small - have initiated the registration process
- Registration takes a couple of days
- Broad geographic representation of banks across the country including all 12 Federal Reserve Districts
- Broad size distribution of banks, with large representation of community banks and more than 10 banks over $25 billion initiated registration process

Encourage Lenders to Register

- Encourage lenders to explore program and learn about the ways it can help them help their business borrowers
- Important to work with borrowers
- Even banks not expecting to take advantage now, may need the program if the economy worsens in the fall
- Can immediately make loans that qualify for program terms knowing the Federal Reserve will purchase a 95 percent interest in loans that meet terms and conditions of program
- Early days of program, but seeing steady stream of interest from borrowers and lenders

Concluding Observations

- Global pandemic has already made existing societal divisions starker
- Path of the economy will be determined by virus containment and public health/medical innovations
- With high unemployment and low inflation additional monetary and fiscal stimulus is justified
- Lending facilities, like Main Street Lending Program can help
  - Source of liquidity for small and medium-sized businesses
  - Backstop against pandemic that is more severe than anticipated this fall