ST. LOUIS FED PRESIDENT JAMES BULLARD DISCUSSES THE RECENT FED ACTIONS

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03/31/2020

Last Friday on our "Behind the Markets" podcast, we had the special opportunity to interview James Bullard, President and CEO of the Federal Reserve (Fed) Bank of St. Louis.

Bullard is very pleased with the Federal Reserve's new policies and Congress' reaction to the crisis. Such policies took much longer to cobble together during the financial crisis of 2008 and 2009.

Is the Fed Out of Ammo?

Bullard emphasized how the 13(3) authority of the Federal Reserve System's Board of Governors is very powerful—and it is what allowed the Fed to finance a new special-purpose vehicle the U.S. Treasury is using to buy all sorts of assets. Further programs could be designed if the Fed determines more is necessary. The general idea of these vehicles is so the Fed can lend to anyone in a crisis situation, as long as the Treasury Secretary approves and the loans meet the requirements in the Dodd-Frank Act.

If those programs are not providing enough of the necessary relief, Bullard emphasized that they would do more, but he was skeptical whether the Fed would extend its asset purchase programs to buying equities.

Bullard's big statements on the economy reiterated predictions he's made on CNBC for unemployment levels to reach upwards of 30% and for the economy to contract nearly 50%.

He calculated how much of the economy is "essential goods and services" and how much can be done in a work-from-home environment. Bullard believes these essentials are less than 50% of U.S. production, in which case gross domestic product (GDP) could be down 50%.

Morgan Stanley forecast that economic activity will be down 30% in Q2 on an annualized basis (7.5% quarter over quarter). Bullard points out this overly optimistic view would mean 92.5% of the economy was either essential goods and services or able to be produced from home. He finds that implausible and an example of how forecasters are having a tough time changing their mindsets during the crisis.

Bullard wants to see extensive use of the unemployment insurance program, because it means we are keeping households whole so they can pay their bills. We are intentionally slowing the economy down, and this is exactly what we want to do to slow the spread of the virus.

Bullard thinks this is a temporary situation, as every virus in history has been a temporary phenomenon. There was nothing wrong with the economy, and we merely shut it down to keep people healthy.

Bullard believes we should be able to switch production, factories and stores back on after this virus passes. He sees most of the disruption happening in the second quarter, and all activities of the Fed and Congress are designed to make businesses and households whole to provide a bridge to the reopening of our economy. He emphasized this idea of a bridge to keep households whole numerous times for the pandemic relief, whether from unemployment insurance levels or the relief to businesses to keep their employees on the payroll.

A former Fed official expressed concern that the Fed was given new powers to directly lend to small businesses. But Bullard believes this power could be very useful in this crisis and he does not object.

Has the Market Overreacted on The Asset Pricing Basis?

Bullard commented that while we might be losing a quarter or two of revenue, these assets still have long-term productive capacity, and the market has become too pessimistic. He agreed with Professor Siegel's statement that over 90% of the value of equities comes from cash flows after 2021.

Please listen to the full conversation below.

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Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Treasury : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

Dodd-Frank Act : Legislation passed in response to the 2008-09 financial crisis, meant to focus on what were viewed as potential shortcomings in the regulatory framework that contributed to this crisis.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Cash flows : a measure of how much cash a business generates after taking into account all the necessary expenses, including net capital expenditures.