Fed boosts support for stock market by expanding corporate debt purchases

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Federal Reserve Board chairman Jerome Powell has warned that there is "significant uncertainty" about "the timing and strength" of any US economic recovery, and the decline in US gross domestic product this quarter "is likely to be the most severe on record."

In testimony to the Senate Banking Committee yesterday, Powell said the burden of the downturn had fallen on those least able to withstand it and "low-income households have experienced, by far, the largest drop in employment."

He said it would take some time before employment and economic activity returned to pre-pandemic levels and there were "parts of the economy that will struggle to return to their old ways of activity," a euphemistic way of saying "Never."

But most of the questioning at the hearing centered on the support that the Fed is providing to the stock market following its decision on Monday to expand its program for buying up corporate debt.

The move was not entirely unexpected, as the Fed had already begun purchases of exchange-traded funds (ETFs) based on corporate debt as part of its massive intervention into financial markets that it began in March after they effectively froze.

In its Monetary Policy Report submitted to Congress prior to yesterday's hearing, the Fed said that in late February and over much of March, loans were "unavailable for most firms" and "trading conditions became extremely illiquid and some critical markets stopped functioning properly."

Over the past three months, the Fed has injected more than $3 trillion into financial markets, twice the amount spent during the global financial crisis, through its asset purchases, which include government debt, mortgage debt and now corporate debt.

According to the *Wall Street Journal*, since the corporate debt purchasing program began on May 12, the Fed has been buying these assets at the rate of around $300 million a day. Now this program is being extended.

The Fed will add to its portfolio by directly buying the debt of individual companies on the secondary market as long as their bonds mature within five years and had a credit rating of at least BBB- or Baa3 on March 22.

But because the ratings on some of these debts have dropped since then, turning them into what is known as "fallen angels," the Fed's commitment means it will be buying so-called junk bonds, i.e., those below investment-grade.

The announcement of the new intervention was carefully timed. After a rapid rise since the plunge in mid-March, as share indexes rose by more than 40 percent to reach levels attained at the start of the year, the market experienced a significant fall last Thursday.

It was precipitated by the economic outlook issued by the Fed the previous day, in which it warned that recovery from the effects of the COVID-19 pandemic could be prolonged and that millions could remain unemployed for an extended period.

The downslide was set to continue on Monday as the Dow fell by more than 760 points in the opening half of the trading day on the back of news of a new outbreak of COVID-19 in China and the continued escalation of cases in a number of US states.

But after the Fed announcement, there was a rapid turnaround, with the Dow finishing up by 157 points. The surge in the stock market continued yesterday. The Dow leapt by 2 percent, more than 500 points, the S&P was up by 1.9 percent and the Nasdaq rose by 1.7 percent.

Announcing its decision, the Fed said it was making the debt purchases "to create a corporate bond portfolio that is based on a broad diversified market of US corporate bonds," and new intervention would complement the purchases of ETFs.

The Fed has said it will implement the expanded buying strategy by following an internally created index made up of all the bonds issued by US companies that met its criteria. According to a report by CNBC, the creation of the Fed index, the details of which have not been made public, removed a potential hurdle for companies that would have to certify they were in compliance with the restrictions for the program.

The head of US credit strategy at BNP Paribas, Dominique Toublan, described the creation of the index as a “significant positive.” “The main reason is that they removed the requirement that issuers certify their eligibility. Many investors were worried that this would impair the ability of the Fed to buy bonds.”

Comments from other representatives of financial firms were equally supportive.

“This is yet another sign that the Fed is going to do everything in their power to help liquidity,” Ryan Detrick, a senior market strategist for LPL Financial told the *Wall Street Journal*. “Worries over a second wave? No worries, the Fed is here.”

Robert Pavlik, chief investment strategist at SlateStone Wealth in New York, said: “No doubt the market liked it. Who doesn’t like more cake and ice cream? It fuels traders to buy individual stocks and take on higher risk because the Fed has backstopped the bond market and kept a tighter lid on interest rates.”

The intervention is being financed by the provision of $75 billion from the US Treasury which the Fed is able to leverage up to create a fund of $750 billion.

Apart from its economic and monetary effects, the latest intervention is politically significant. It removes completely the last vestiges of the Fed’s already tattered fig-leaf claim that its market interventions are solely aimed at improving the flow of credit to households and businesses and supporting the “economy” rather than being directed to Wall Street.

Patrick Leary, chief market strategist at Incapital said the “stock market…is the real issue here. It’s a reminder to the marketplace that the Fed is here with its balance sheet and is going to deploy that balance sheet to try to support markets and market functioning.”

Numbers of commentators recalled the famous saying of William McChesney Martin, chair of the Fed from 1951 to 1970, who said the task of the central bank was “to take away the punch bowl just as the party gets going.”

In the present situation, as *Financial Times* markets commentator Mike Mackenzie noted, “the central bank punch bowl just gets bigger and bigger.”

This has created a speculative orgy in which shares in companies that are either recording losses or have been unable to issue any estimates of their revenues are being bought up on the expectation that the Fed will continue to pour in money.

The most egregious expression of this process is the car rental company Hertz. Last week, a judge in a Delaware court granted it approval to raise up to $1 billion through a new share issue even though it is in bankruptcy.

There was an illuminating exchange during the Senate hearing. Asked by Louisiana Republican Senator John Kennedy as to whether the Fed had any plans at some point in the future to reduce its holdings of financial assets, now running at more than $7 trillion and predicted to reach at least $9 billion, Powell initially responded with a nervous laugh.

After composing himself, he replied that the Fed’s asset holdings would fall as a percentage of GDP as the economy grew.

Powell no doubt tailored his answer in line with his experience of late 2018. His statement at that time that the Fed was planning to reduce its holdings by $50 billion a month, in an effort to return to something resembling “normal” monetary policy, met with a furious market response, whereupon the plan was promptly shelved.

Two interconnected processes have been set in motion by the Fed’s escalating supply of money to the financial markets. On the one hand, the orgy of speculation is creating the conditions for another financial crisis. On the other, it is intensifying the drive to further restructure class relations and intensify exploitation of the working class in order to try to pump value into the ever-growing mountain of fictitious capital.