Conversations with the St. Louis Fed
Friday, April 3, 2020
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Jim Fuchs:

Thank you, Dagma, and good morning, and good afternoon to those of you who are in the Eastern time zone portion of our district. This is our second, I guess I would call it COVID edition of the Conversations with Fed program. We launched this last week to create an open forum to address questions that we hear from you throughout the week and also during this call.

I'm Jim Fuchs, vice president at the Federal Reserve Bank of St. Louis, and we're going to move pretty quickly into a variety of topics that we've heard from you. However, if you do have questions, please email them to conversations@stls.frb.org. So a number of you have done that, appreciate that; that's one mechanism certainly. You have a lot of contacts with the leadership and staff here in Supervision of the St. Louis Fed so continue that as well. We're compiling everything we get, and we're trying to answer the most frequent questions that we hear during the week. But again, we are monitoring it during this call so if you have a question as we start talking today, please feel free to do that.

Again, this session is being recorded and will be archived on the Conversations website, which is www.supervisionoutreach.org/conversations, and if you go there now, you can see last week's call and you can also see some of the resources we discussed. In fact, anything we discuss today that we can link to in the resources section we will do that. So again, last week, real quick we went through Fed staffing and our remote work engagements. We talked a little bit about banks working with their borrowers, talked about the interagency statement on loan modifications, a pause in exam work. So those are some of our topics if you want to hit that archive from last week, please feel free to do so. This week, obviously a whole new set of issues have arisen and we will do our best to cover them. And to kick us off, I'm going to turn the call over to our senior vice president in charge of Supervision, Carl White. Carl, the floor is yours.

Carl White:

Thanks, Jim, and thanks, everyone, for joining us again today. I know everyone is swamped and carving out 30 minutes of your day. We really appreciate it. We feel that this is an important part of our communication strategy, so I just wanted to touch on a couple things real quick, and then we'll get into some of the other speakers.

Obviously, all of you are aware of the rollout today of the Small Business Administration (SBA) Paycheck Protection Program (PPP). It has gone live. While the program is up and running, we have heard—many banks have contacted us with concerns about the program, whether it's access, whether it's issues with the forms themselves, or just questions about the program. So, we hear your issues, we feel your pain. We're trying to get as much information as we can as well. So what I would suggest is if you have questions, if you're not getting answers from either the SBA website or through your normal channels, please submit them through the conversations@stls.frb.org site just like you would submit questions for these calls. And we're trying to coordinate those questions with a small team here so that we can try to get answers to questions if you're not getting them, and we'll do the best we can to get that information out to you as soon as we can.

I did see today that the Treasury Secretary did tweet that almost $1 billion has been processed, and he did note that that's almost entirely by community banks. I will say that's not surprising to me, because what I've heard anecdotally is the larger banks really won't be ready to jump in until sometime next week. So take that for what it's worth; next week will be an interesting week as well. So, once again, if you have questions or issues, please send them through that Conversations link and we'll do the best we can to address those for you.

The last thing I'll mention is next Monday we will have an Ask the Fed® session. Actually, we're going to be doing two sessions—one in the morning, one in the afternoon—same topic, same talking points, so you only need to sign up for one, but that's going to be on the stimulus payments. We're not calling them stimulus payments; we actually have a new name, they're called economic impact payments. So that's going to be our folks from Treasury who will talk about how those payments will be made, so that will be an interesting topic. So, certainly sign up and join those Ask the Fed sessions.

So that's all I had to report this week, and I'm going to turn it over to Bill Emmons. I'm sure many of you have heard Bill speak in the past or have listened to his Take Five with Bill sessions that we do after each Federal Open Market Committee (FOMC) meeting, but he's going to give some talking points on the economic environment, so I'm going to turn it over to Bill.

Bill Emmons:

Thank you, Carl. Let me say first these are my own views, not those of Carl or anybody else at the St. Louis Fed or anyone around the Fed system. So what I want to do is speak briefly about the national economy, just a little bit about our regional economies, and then turn to financial markets and look at a couple of parts of the financial markets and the commodity markets also, to kind of give a high-level view of what I think is going on.

So at the national level, you probably saw today's employment report. This is the monthly report on job growth and the unemployment rate. So today's report was the worst since 1975, 45 years ago. The report showed that the month-over-month change in the unemployment rate nationally was up 9/10 of a percentage point from 3.5% to 4.4%, and they said that's the largest single-month increase in 45 years. You have to go back to 1953 to find a month even worse than this one we just reported out. The month-over-month change in nonfarm payroll employment was a decline of about 700,000 jobs. And we had been adding a couple hundred thousand jobs each month before this. So that's what we heard today.

But: You ain't heard nothing yet; next month's employment report could well be—brace yourself—ten times worse than this. Now, the reason that this is coming out right now, this employment report today that seems so out of date, is because the survey week contains the twelfth day of each month. And as you recall, things were really just heating up in the second half of March.

So it is entirely possible that the unemployment rate could go up to 10% next month, which would match the Great Recession peak. It's also possible, based on the weekly jobless claims and unemployment insurance claims that have come in the last two weeks, we could lose in one month 10 million jobs. So these numbers are just beyond anybody's imagination of how quickly an economy could go from growth to freefall.

And so I would say that without the CARES Act, the other federal government programs, without all of the activities that the Fed is undertaking right now, we would be heading into another Great Depression. I don't think there's much doubt about that. President Jim Bullard of the St. Louis Fed has talked about a 50% annualized rate of decline in the economy; 30%+ unemployment if nothing is done. But of course something is underway.

There is right now a discussion that the suppression measures are hurting the economy. Absolutely, it is a self-imposed recession in the sense that we are shutting down the economy. So the question is, what if we called off these virus suppression measures that are strangling the economy? And I think the honest answer is we just don't know; we don't know how that would work because we've never confronted anything like this before. My reading of the evidence and the arguments is that it would likely delay, but not eliminate, these huge economic risks that we're facing, because until we're able to actually manage the virus, our economy is going to remain in severe danger.

So let me say a little bit about our regional economies. We are still waiting to get good information at the state and local level. That always takes a little bit more time, and it'll only be later this month in April when we start to get some of those reports. For what it's worth, as of February, we probably were still growing in our regions, maybe slowly in some areas, but still moving forward, and then in March the picture changed completely. I went back and looked at previous business cycles and of course, this one is different, but to the extent we are going to have similar tracking properties to previous cycles, we tracked the nation pretty closely. We need to keep that in mind.

So we should be bracing ourselves for some very, very negative reports on our local conditions as those start to come in. There is, I think, some chance that some of our states will be a little bit more out of sync with the national economy this time, probably trailing behind it if the virus hits us at different times and that, I think, is a possibility.

So let me turn to financial markets briefly. Looking at the short-term interest rate markets, the money markets—the Fed interventions in commercial paper and several other areas have made a huge difference. But markets are still not functioning smoothly, generally, and that's even true in parts of the money market. Flight-to-safety pressures are still very, very strong across markets, favoring the Treasury market over other fixed-income markets. In the long-term interest rate markets, we had a bizarre period from about March 9 for about two weeks when spreads were exploding long-term yields of all types, including AAA corporate bonds were rising, a bizarre phenomenon when we knew the economy was very weak, even high-quality bonds, even Treasury yields were pulled into this briefly.

I think that has passed. We're now back in a much more sensible situation where those long-term yields are starting to make sense again, given the economic situation. That being said, the credit spreads, for example, BB over Treasury, even AAA over Treasury, those are still much larger than they were just a month ago. But they do seem to be reflecting reality a little bit more than they were. So market dysfunction is not gone, but it's much reduced.

As for commodity markets, broadly speaking, the agricultural commodity prices are down much less than energy prices, and even the stock market. So for example, soybeans, wheat, rice prices are almost unchanged from two months ago. I went back and looked from the very beginning of February to the beginning of April. Corn is down 12%—these are futures prices—the livestock prices are down more, 24% for live cattle; 21 for lean hogs. But with those exceptions, the ag complex does not appear on balance to have been hit as hard as, for example, metals, and certainly energy. Oil is down close to 50% even from that two-months-ago comparison. Ethanol is down 37% from the beginning of February; natural gas down 15%. So quite a variety of experiences across those markets.

Let me now turn to the stock market, where probably this would be my judgment, we're probably in a bear market rally. That is to say, we've had a strong rebound since the lows on March 23 as of the close last night, the S&P was up 12% from that low point. But the reason I say this is likely a bear market rally, not a new bull market, is that stock market volatility and economic policy uncertainty are still sky high. There seems to be no way, in my judgment, that we have returned to a normal investing period. The risk in the stock market—indeed across markets—remains very high, and that's reflected in these day-to-day volatilities that are just astounding. Looking within the stock market, the large caps have done much better than the mid-caps and especially the small-cap stocks. Financial stocks have been hit very hard, more so than industrial and other nonfinancial stocks.

So let me sum up by saying the economy at this moment is in freefall, and that will be true until the government support programs kick in. Some of that has happened in financial markets; the Fed was kind of able to move more quickly than the federal government. But until everything really starts to gain traction, the economic situation is very, very frightening right now. Local economies are likely to track the nation really no matter what we do. As for financial markets, I think we've hopefully reached rock bottom around March 23. Of course, there could be another leg down, depending on developments, but things are improved but still not back to normal.

I still think that the single best real-time indicator of where we are in terms of the financial system is the stock market, and day to day it's crazy, but it seems that we have at least found some pocket of stability after the really big declines earlier. And in terms of where you should go for the best information about really where overall policy is headed and the economy, I would say St. Louis Fed President Jim Bullard is the most free thinking or clear speaking of all of the economic leaders we have right now. So it would be great if you just keep track of what he's saying about the economy. Let me pause there or stop there and pass back to Carl or Jim.

Carl White:

Thanks, Bill, and just to reiterate what Bill mentioned as far as following what President Bullard is saying, if you go to stlfed.org, and I think I mentioned this last week, there's a section on COVID-19. You can click on that and you can read not just President Bullard's statements but blogs by other research economists here at the St. Louis Fed. So some great information there, very timely; on a day-to-day basis, there's more information being released.

Next we wanted to cover—we have received more and more questions about the discount window. AVP Winchell Carroll, who oversees the window for us here in St. Louis, is going to talk briefly to cover some of those questions and just kind of walk you through operationally the window and how it's changed. So I'm going to turn it over to Winchell.

Winchell Carroll:

Okay. Thanks everyone. Bill left a pretty tough act to follow up on, but I'm going to spend some time talking about what does it take to set up a borrowing arrangement with the Fed and what does it take to pledge collateral. And also, what are realistic expectations in terms of the timeline it will take to do all this.

I'm probably going to cover a lot of material here, which might be challenging to follow at times. I'm going to suggest at the start that if you have any questions about the discount window that you either go to the frbdiscountwindow.org site—there are a lot of frequently asked questions out there—or if you prefer, you could call our toll-free number at 866-666-8316 and talk to one of our analysts. They'd be more than happy to walk you through any questions that might arise about discount window usage.

So what are the keys to setting up a borrowing arrangement? It basically starts off with you have to have the proper documentation in place. And the documentation that you have to have in place all comes out of the Federal Reserve Operating Circular No. 10. So there are basically four to five key documents that you have to complete in order to set up a borrowing arrangement.

The first is you have to have a letter of agreement, which is basically indicating that your institution will conform with the standards of OC-10. You also have to complete a certificate, which basically indicates that your institution is in good standing with the current laws and other practices. You also have to have an authorization resolution from your board of directors, which basically indicates that the board is approving your institution to borrow from the Federal Reserve. And probably most importantly, you need to have a list of authorized borrowers. So this will be the list of officials at your bank that can actually call the discount window staff and request a loan.

And in this environment, I just encourage you to take a fresh look at your list. If you've already completed this information, or if you're considering completing such a list, you might want to consider adding some additional names in this environment, because you don't know if everyone will always be available to conduct work in such an environment. But one thing I wanted to point out is that if somebody called to request a loan, they have to be on that list. And a lot of institutions have required two authorizers to request a loan. So you have to have both individuals call in order to truly transact a loan. And then finally, in the event that your institution doesn't have a master account with the Fed, you would need to complete a correspondent agreement so that we could route any borrowings to your correspondent accounts.

So in terms of time expectations, this could be done in literally a day or so, if the stars are completely lined up, and I'll get into a little bit about what that means in a second. But realistically, it generally takes most institutions about a month to get this information put together. So if you're thinking that you're going to come to the window today and get a loan and you haven't completed the documentation, it's probably going to be very challenging. And in some situations, it may even take an institution two to three months to complete this information, so I just wanted you to be aware of that.

And really, the key determinants of how quickly you can get the information done is management determination, if this is a top priority for you, you can probably get it done faster. But a real key factor is are your directors available to sign these documents to move the process forward. And that's why we generally see that it takes from a month to two or three months to get this done, because you have to have your board available to complete some of this information. And then you also have to make sure that information is completed, again, correctly, that if information missing, we'll have to submit it back to you.

You may have a question about this environment, since it is difficult to track people down. Normally we require wet signatures to occur on all these documents, but in this environment, we would be willing to accept electronic signatures or electronic documents. We would just ask that in the long run that you mail in hard copies of documents with wet signatures on them.

So if time is of the essence, the next step in the process is really determining what type of collateral you're going to pledge. And in essence, that comes down the decision of whether you're going to pledge securities or loans or both. Just as a general statement, it takes a lot less time to pledge securities than it does loans.

If time is of the essence, pledging U.S. Treasuries and agency securities will be far and away the fastest process. But of course, because that collateral is highly liquid to begin with, very few people tend to pledge that type of collateral. As of the end of this month, only about 4% of the collateral pledged at the discount window was comprised of Treasuries or agency securities, so they're relatively rare. But if you do pledge government securities, we can generally perfect our position in those securities in just a matter of hours. Nongovernment securities are going to take longer, and a lot of that will depend upon where your securities currently are right now. Are they with a correspondent? Are they with a safe keeper? Determining where your securities are currently held will have a big basis as to how long it takes us to perfect our position on them.

Also, you might want to think about things such as lien status. Do you have securities that are currently pledged right now so that they wouldn't really be eligible to move to the discount window? You might need to reposition securities. These are things to think about, and one other thing that sometimes can trip up institutions is that you have to have a U102 account with the Fed, which is basically an account to transfer these securities into the Fed account. In reality, most institutions have a U102 account, they just tend to not be aware of that. But that's an activity that you need to interact with our wholesale product office, which is separate from the discount window. So if you needed to ensure that you have you a U102 account, you need to go to frbservices.org and contact the customer contact center to ensure that you have such an arrangement.

Okay, moving on, most organizations are going to pledge loans, and unfortunately, pledging loans will take time. And here's where you will experience—we've had some bankers express some frustration; they just want to know why it takes an extended period of time to pledge loans, and all I can say is you just need to be thinking about the things behind the scenes that have to happen when you originate a loan at your institution. It takes time to do title searches, it takes time to collect lien releases, to collect subordination agreements, to file Uniform Commercial Code (UCC) filings, and to have legal reviews done. And of course, in this environment, all that work is probably going to take a little longer given know how much stress people are working under.

So those are things to be thinking about. And also when it comes to loans, in most instances, the institutions that we're dealing with probably are already engaging with the Federal Home Loan Banks, or they have correspondent banks where they're obtaining their lines of credit. So generally, the Federal Home Loan Bank is going to have a blanket lien across most, if not all, of your loans. And so for us to perfect a position in loans that you decide to pledge, we'll have to go to the FHLB and seek a lien waiver from them.

Continuing on with the loan element of this, in order to pledge loans, you have to complete a document called the borrowing custody certificate, and it is a rather lengthy document. It's about 22 pages, and it's asking a lot of questions about what type of loans you're going to be pledging. Are they paper documents or are they e-documents? It's going to be asking questions about your collateral management practices, your loan rating systems, things of that nature, because these loans are going to be held at your institution in most cases because you will have a borrowing custody agreement going on. And therefore we just need to make sure that collateral that we'll be using for loans is in good hands and properly being safe kept.

Another thing that's required when loans are pledged is that it will require a Borrower-in-Custody (BIC) visit and a big examination. A BIC visit is usually just a previsit of what your custody arrangements are going to be, and then we'll come out and do a more extensive BIC examination. In this environment, fortunately, we're waiving that. But under normal standards, that was something that would be happening, and we just want you to be aware of that. But we tend to get a lot of questions from bankers asking why can't I just submit a list of loans to you and move forward, and it basically comes down to—the Fed, by its policies, has to make sure that all loans are 100% collateralized. So we need to make sure that we have our positions perfected before we can just start issuing loans.

Because the Fed has issued some new guidance about the discount window, we just wanted to let you know, if you haven't seen this already, that on March 15, starting on that date moving forward, we're now offering term loans at the discount window, which are loans that can be made for terms of up to 90 days. There is one thing you need to be aware of, though, if you do obtain or seek to obtain any loan that extends for a term beyond 28 days, you're only allowed to borrow up to 75% of your available collateral valuations, and that's basically being done, more or less, for your own protection—that if somebody came in and borrowed all of your available collateral you wouldn't have anything left if an unexpected shortfall happened. And so this is the holdback that we placed there. But you would be able to borrow on the remaining 25% for durations less than 28 days. Just something to be aware of if you do come to the window.

And then we're also fielding more and more questions each day about electronic signatures. And in this environment, we're kind of going in a transition phase, where we haven't had a whole lot of interest in institutions pledging loans with e-signatures. But in this environment, we could probably anticipate that that will start to change. And when I talk about electronic documents, I'm talking about documents that have either been digitized—they started off in paper form, now they're moving over to electronic form—or loans that truly are fully electronic from start to finish and signed electronically.

So in most cases we will accept such loans; the one exception, though, at the moment, is anything that's mortgage related. There are still legal issues behind ensuring the promissory notes are legitimate. State laws tend to be a little unsettled on that still. That's one type of collateral that we probably would not accept. But otherwise, almost all of the loan types in electronic form, we would accept those. Just things to be thinking about when it comes to what you might pledge if you're interested.

So I'm going to stop there. Hopefully I haven't scared you off by explaining what the process looks like. But if you are interested in utilizing the discount window, please reach out to one of our analysts and we will be more than happy to help you.

Carl White:

Thanks, Winchell. It is a process, so please reach out to us if you have questions. So, we're right at the top of the hour so we're going to wrap things up. Before I turn it over to Jim, I did want to announce that for next week's call I was able to book Mr. Bullard. So President Bullard is going to talk to us for five or ten minutes, so please register for next Friday's call; that should be very interesting. So I'm going to turn it back over to Jim.

Jim Fuchs:

Great. Thanks, Carl, and thanks to all of you for participating this morning, we know a number of questions came in. Again, we intentionally made this a half-hour program because we know you're getting pulled in a lot of different directions. We will follow up with some of our individual questioners, but also, a number of questions are coming in on the Paycheck Protection Program just launched today. We are figuring things out, and as Carl mentioned, please keep those questions coming in, because if you're not getting answers, we want to know what you're asking, and we will use our channels to do that and you can use conversations@stls.frb.org.

So thanks again for joining us today. This call has been recorded and will be archived in the Conversations website, and we look forward to talking to you next week, answering your questions, but also hearing from President Bullard. Thanks, everyone, and have a great rest of the day and great weekend. Take care.