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Life After Debt: Government Sets Sites on Historic Stimulus (Part II of IV)

U.S. Government's Size and Role Transformed as Counter-cyclical Spender and Lender

Government is a growth industry these days. The unprecedented monetary and fiscal response to the current recession and financial crisis include interest rate cuts, a recapitalization of banks, quasi-nationalization of several institutions, liquidity injections, increased deposit insurance, government purchases of assets, and past and potential future fiscal stimulus plans. In response to the housing crisis, the financial crisis, and the recession over the past 20 months, the Federal government and its agencies have committed a staggering $12.8 trillion, of which more than $4.1 trillion has already been pledged. For perspective, the nation's total economic output as measured by gross domestic product (GDP) was $14.2 trillion in 2008. The Federal government's budget is expected to top $1 trillion this fiscal year, representing over 7% of GDP. State and local government budgets are also experiencing financial stress due to lower sales, income and capital gains taxes.

In an effort to stimulate the economy, the new administration and Congress recently passed a $787 billion fiscal spending plan. The stimulus package focuses on transportation and infrastructure spending, energy efficiency, school repair, expansion of broadband internet access and medical technology. It could be a positive for some industries and help stabilize state government budgets, although government spending has historically been less efficient than private sector spending. In an effort to remove toxic assets from bank balance sheets, the Treasury recently outlined details of its Public Private Investment Plan whereby it will attempt to "crowd in" private investors with loan guarantees along side the government.

In addition to the neo-Keynesian policies aimed at stabilization and future growth, the government is taking on more risk by transferring private sector credit risk to itself. The move could potentially increase government borrowing costs. To keep market interest rates low, the Federal Reserve has embarked on a program to purchase U.S. Treasury securities. By increasing the bid for Treasury notes, the Fed is attempting encourage borrowing with artificially low market rates, as the price and yield for bonds maintain an inverse relationship.

The U.S. will also need to compensate foreign creditors for continuing to purchase the rapidly expanding supply of its debt. To attract capital in an environment with a weakening economy and deteriorating credit quality, two possible incentives would be higher interest rates or a less valuable currency, which makes assets cheaper to foreign purchasers. Since higher rates would provide a negative impact to the housing market, we would anticipate weakness in the U.S. dollar. The Federal government's policies to "prime the pump" could also eventually spark inflation, which erodes a currency's value. Gold, as a store of value, could benefit, as it represents an asset outside of the credit system with no liabilities.

Once the fiscal stimulus plans are addressed in Washington, we expect to see a new wave of greater regulation, aimed primarily at the financial services industry. The government will also eventually need an exit strategy from the numerous markets in which it now participates, and a determination of the future size and role of Fannie and Freddie. Overall, the size and scope of government's economic participation has undoubtedly increased for the foreseeable future.

Government Response to the Recession and Financial Crisis
As of March 31, 2009

Institution/Agency and Program	Pledged (billions)	Provided (billions)
Federal Reserve Total	**$7,765**	**$1,683**
Primary Credit Discount	$110	$61
Secondary Credit	Unlimited	$1
Primary Dealer Credit	$147	$20
Asset-Backed Commercial Paper Liquidity	$152	$7
AIG Credit	$60	$43
Net Portfolio CP Funding	$1,800	$241
Maiden Lane (Bear Stearns)	$29	$29
Maiden Lane II (AIG)	$23	$18
Maiden Lane III (AIG)	$30	$24
Term Securities Lending	$250	$89
Term Auction Facility	$900	$469
Securities lending overnight	$10	$4
Term Asset-Backed Loan Facility	$900	$5
Currency Swaps	$606	$378
Money Market Investor Funding Facility	$540	$0
Purchase of GSE debt and MBS	$1,600	$286
Guarantee of Citigroup and Bank of America debt	$308	$0
Commitment to Buy U.S. Treasuries	$300	$8
U.S. Treasury Total	**$2,694**	**$1,834**
Troubled Asset Relief Program (TARP)	$700	$600
Tax Break for Banks	$29	$29
Stimulus Package (Bush)	$168	$168
Stimulus Package II (Obama)	$787	$787
Treasury Exchange Stabilization	$50	$50
Student Loan Purchases	$60	$0
Support for Fannie Mae and Freddie Mac	$400	$200
Line of Credit for FDIC for Public-Private Investment Plan (PPIP)*	$500	$0
Federal Deposit Insurance Corporation (FDIC) Total	**$2,039**	**$358**
Public-Private Investment Plan (PPIP)	$500	$0
FDIC Liquidity Guarantees	$1,400	$317
GE	$126	$41
Citigroup Bailout	$10	$0
Bank of America Bailout	$3	$0
Federal Housing Authority (FHA) Total	**$300**	**$300**
Hope for Homeowners	$300	$300
Total	**$12,798**	**$4,175**

* The FDIC's commitment to guarantee lending under the PPIP includes a $500 billion line of credit from the U.S. Treasury.
Sources: The Federal Reserve, the U.S. Treasury, the FDIC, the CBO and Bloomberg.