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Analysis on the Currency Policies in Respond to the Economic Recession after COVID-19 in the United States

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Abstract: The March 2020 onset of the COVID-19 recession precipitated an unparalleled fall in economic activity throughout the planet. To combat recessions, central bank policymakers employed various expansionary monetary policies. Through a literature study, the paper focuses on a discussion of the monetary policies adopted by the Federal Reserve of the United States. This paper examines three basic areas of monetary policy: regulatory changes led by the Federal Reserve, interest rate changes, and loan and asset acquisitions or quantitative easing. The study not only provides a full explanation of the adopted policies, but also takes a critical and objective look at the overall currency policies adopted by the Federal Reserve of the United States. Following an economic downturn, the report concludes that the Fed's measures were effective in commencing a period of economic recovery for the nation.

Keywords: quantitative easing, loan and asset purchase, liquidity, recession, economic recovery.

1. Introduction

The introduction of COVID-19 at the start of 2020 caused abrupt economic upheavals and a general disturbance of the financial system. Specifically, liquidity evaporated from conventional paper markets and the Treasury. The majority of financial institutions, such as hedge funds and money markets, were severely disrupted [1]. The commercial banking system of the United States fared well despite the crisis, as restrictions implemented before to the crisis allowed banks to enter the crisis relatively well-capitalized. However, this was insufficient to ensure that banks would continue to supply adequate liquidity during the crisis. Local, state, and1 federal officials took various measures to prevent the virus's spread, although the majority of these measures restricted economic activities [2]. The result was a recession that left many unemployed. The efforts taken by the Federal Reserve following the recession assured the continued supply of credit to families and companies. These measures helped steer the economy toward recovery by preventing future disruptions of the financial markets. In other nations, credit flows primarily through the banking system. However, in the United States, a considerable part of credit flows through capital markets. For this reason, the majority of monetary policies undertaken by the Federal Reserve of the United States were designed to ensure the smooth operation of financial markets.

Several related papers currently focus on the relationship between monetary policy and the stock market, or focus only on the impact of a particular monetary policy on the economy, so this paper, through a method of literature review, focuses on an in-depth study of the monetary policies established by the Federal Reserve of the United States. This article examines three basic areas of monetary policy: regulatory changes led by the Federal Reserve, interest rate changes, and loan and asset acquisitions, or quantitative easing. This paper is notable because it contributes to the field's body of knowledge.

2. Analysis of US Monetary Policy During COVID-19 Recession

The Federal Reserve's stimulative initiatives fall into three basic categories: interest rate reductions, regulatory changes, and loan and asset acquisitions. At the onset of the epidemic in March 2020, the Federal Reserve reduced its benchmark interest rate, the federal funds rate, initially by 0.5% and then by 1% [3]. This decreased the federal funds rate from 1.5% to 1.75 percent to 0% to 0.25 percent. It is noteworthy that the Fed has not increased interest rates by more than 0.25 percentage points since the Great Recession of 2007 [4]. The federal funds rate influences long-term interest rates and serves as a benchmark for short-term interest rates. Thus, the change was designed to encourage expenditure by reducing the cost of borrowing for firms and consumers. In the same month, the Fed lowered its discount rate to 0.25 percent, representing a decrease of 1.5 percent [4]. Figure 1 depicts the decrease in the federal funds rate in March 2020.

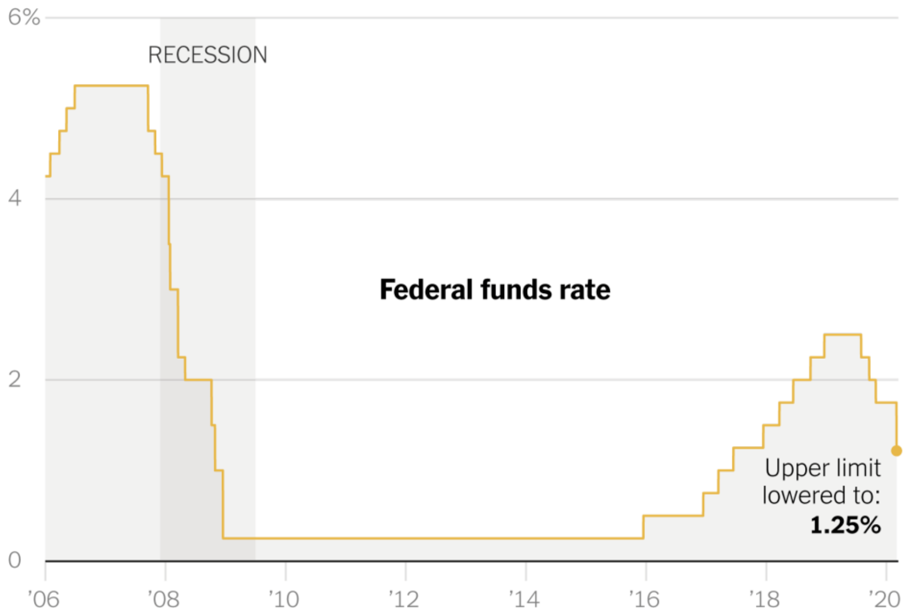

Figure 1: The reduction of federal funds rate in March 2020 [5].

Continuing with the topic of interest rates, it is essential to remember that the Fed chose forward guidance as a monetary policy strategy. In essence, the Federal Reserve provided forward guidance regarding the future course of interest rates. Initial indications were that the organization would maintain near-zero interest rates until it was convinced that the economy had recovered sufficiently from the recession to achieve price stability and full employment [6]. In the fourth quarter of 2020, the Federal Reserve reinforced this guideline by emphasizing that low interest rates would be maintained until inflation hit 2% and the labor market met specific parameters. By the end of 2021, the inflation target of 2% and above had been met [4]. Furthermore, the job market was approaching full employment. Accordingly, the Federal Reserve stated that a substantial proportion of its members would raise their interest rates by 2022.

The Fed's second type of currency or monetary policy, loans and asset purchases, consisted of broad purchases conducted as part of repurchase operations and quantitative easing, in which the Fed directly purchased assets or developed particular credit programs [7]. Notably, the Fed established organizations - special purpose vehicles - to which it provided money for the acquisition of properties. It was intended to prevent a liquidity crisis.

Still focusing on loans and asset purchases, the Federal Reserve extended its repo operations dramatically, initially by $1.5 trillion and then by $0.5 trillion shortly thereafter. With the intention of funneling capital into money markets, the Fed dramatically boosted the size of its repo operations. In the repo markets, firms lend and borrow securities and cash on a short-term basis. It is essential to recognize that disturbances in this market can have a substantial effect on the federal funds rate. Due to this, the Federal Reserve's operations in the enabled dealers to acquire government-backed assets in return for cash [8]. Quantitative easing in the United States between 2020 and 2022 is depicted in Figure 2. The expansion was steady.

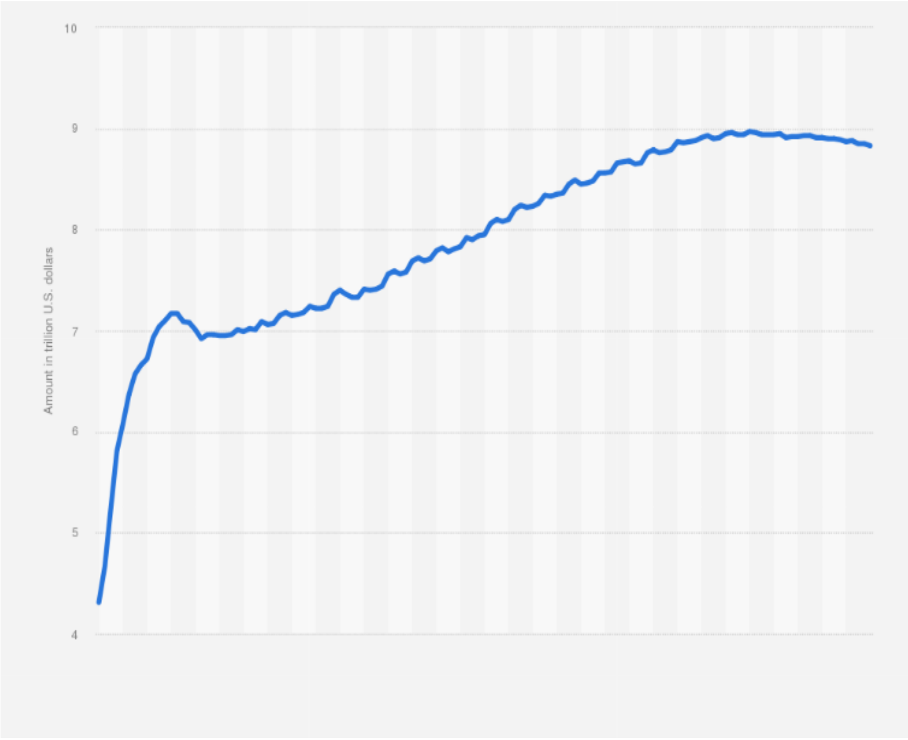

Figure 2: Quantitative easing in the United States between 2020 and 2022 [9].

The purpose was to ensure that the money markets had sufficient liquidity. This action enabled the Fed to purchase Treasury securities from banks and lend to them. The Fed would thereafter sell the Treasury securities to banks. In addition, the Fed resumed its huge purchases of debt instruments. During the global economic recession of 2007, this was a crucial instrument that was utilized. The COVID-19 epidemic had precipitated severe dysfunction in mortgage-backed securities and the Treasury Department [10]. Considering the importance of these markets to the flow of credit across the economy as a whole, the Federal Reserve's loan and asset purchases served to restore the markets' normal functioning.

Additionally, the Fed lent to securities firms. The Global Financial Crisis led to the development of the Primary Dealer Credit Facility program. The Fed issued low-interest loans to a number of major dealers, which are essentially large financial institutions, following the pandemic-induced recession. The major dealers provided collateral in the form of municipal bonds and commercial

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paper, among other securities. The Fed's purpose was to enable dealers to maintain a functioning credit market.

The Federal Reserve adopted regulatory adjustments as the third type of monetary stimulus measures following the pandemic. They were intended in part to further increase market liquidity [11]. For instance, some technical adjustments were made so that the Fed could retain less capital and hence lend more. The temporary easing of restrictions placed on Wells Fargo following the company's accounting debacle is a clear example of this.

In addition, regulatory modifications were implemented regarding several concerns that affected small banks. The Federal Reserve, for instance, gave short-term regulatory relief regarding the community bank leverage ratio, appraisal standards, and regulatory reporting deadlines. The institution simplified examinations for smaller banks further [12]. This implies that banks had additional resources and time to adapt their operations to meet the financial needs of the community and their customers. Through the Paycheck Protection Program, the banks could also lend to small businesses.

In essence, the Fed temporarily loosened regulatory constraints to enable community and major banks to increase lending during the pandemic by dipping into their liquidity buffers and regulatory capital. In order to prevent repeat bailouts and bank failures, rules implemented in the wake of the 2007 Global Financial Crisis required banks to retain additional loss-absorbing capital [8]. However, the reforms included measures that let financial institutions to use their capital buffers to sustain lending during economic downturns. Thus, the regulatory changes were defined by the Federal Reserve's support for the aforementioned lending through modifications to the reserve's total capacity to absorb losses. The modification permitted the reserve to apply limits in phases, constraints tied to deficiencies in the capacity to absorb losses. For their part, financial institutions ceased share repurchases in an effort to preserve capital. The elimination of the reserve requirements for banks by the Federal Reserve [2] is another significant modification to the regulatory requirements. During the pandemic, the Fed also prohibited the share repurchases and dividends of bank holding corporations. However, these restrictions were repealed in June 2021. At this point, financial institutions had demonstrated that they had adequate capital to support lending, even if economic performance fell short of expectations.

3. Discussion on the United States' Currency Policies

After analyzing the Federal Reserve's monetary measures in response to the pandemic, it is concluded that the policy actions were unprecedented in terms of speed, scope, and size. An in-depth examination of the three broad kinds of policy measures adopted by the Federal Reserve of the United States demonstrates that the institution acted decisively, utilizing various tools to construct and design credit-supporting facilities for consumers and enterprises [10]. Some of these tools were created during the Global Economic Recession of 2007 and were modified in response to the current economic recession. Together with fiscal policy responses, currency measures have played a significant role in driving the current economic recovery in the United States. Spiegel demonstrates that the Federal Reserve of the United States was successful in encouraging growth due to the introduction of more advantageous long-term financing conditions and higher stock values [12]. The fact that the currency policy precipitated a dollar decline is also indicative of the success of the strategy. Thus, the measures promoted the economic competitiveness of the United States.

A close examination of the policy stages reveals several intriguing patterns that lead to a deeper understanding of the future ramifications of the policy actions. In the last five decades, the second quarter of 2020 witnessed the most restrictive approach to currency policy. This corresponds to the time when the epidemic had the greatest impact. At this time, the economy of the United States was relatively weak. The real GDP was well below its potential. Inasmuch as the Federal Reserve employed a variety of policy tools to loosen monetary policy, this was insufficient to combat the sluggish economy [1]. On the other hand, it follows that the fourth quarter of 2021 witnessed one of the most accommodating monetary policy approaches of the past five decades. Notable is the fact that the economy had fully recovered at this stage, with GDP performing around 1.4% over its potential level. In the meantime, monetary policy settings were simple. Considering the most restrictive and most flexible positions of monetary policy, these trends demonstrate an important relationship between currency policies and economic health. Objectively, it illustrates the significance of comparing policy settings to the current economic climate in order to determine the attitude of monetary policy [4]. Insofar as the Federal Reserve did not change the federal funds rate between the beginning of the epidemic and the time of full recovery, the impact of the policy changes over the course of the three-year period was minimal. Comparing the policy to the strength of the economy would aid in initiating required adjustments.

Overall, the Federal Reserve's diverse policies played a crucial role in ensuring credit flow to households and the market. Some of these initiatives were just a continuation of those implemented during the 2007 global economic recession. Similarly, it is anticipated that future periods of economic slowdown or recession will learn from how the economy was brought back to full health following the pandemic.

4. Conclusion

The COVID-19 pandemic faced fundamental problems to the economy and the Central Bank as it attempted to implement effective monetary policies that would steer the economy onto the road to recovery. In spite of these unprecedented times, policymakers devised new instruments and adopted unorthodox monetary policy techniques, such as emergency lending programs, quantitative easing, and exceptionally low interest rates. This paper examined the United States' monetary policy and, in particular, the Federal Reserve's active role during the crisis. The climax has been a greater comprehension of the significance and efficacy of the policies. This article has focused on three distinct sorts of currency policies. The first concern is with interest rates. In this aspect, the research demonstrated that the Federal Reserve decreased interest rates to make credit more accessible to families and small businesses. The second category was loan and asset acquisitions, and the debate established that quantitative easing was utilized to bolster the credit market by enabling financial institutions to purchase loans and assets. The fourth category was regulatory reforms, which consisted of temporary modifications to the regulations designed to increase market capitalization.

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