



Invesco Perspective

Economic Stimulus Made Simple

April 2009

Another day, another dollar (times a trillion)

Barely a day goes by without news of a multibillion dollar stimulus plan, rescue package or industry bailout. After a while, these headlines start to run together. And soon, it becomes difficult to determine one program from the next.

To help you keep track of the timeline and events, below are some of the major initiatives of the past 13 months.

February 2008: Economic Stimulus – President Bush signed a \$168 billion economic stimulus package that included rebates for taxpayers and tax breaks for businesses. The idea was to ignite new spending in a slowing economy.

March 2008: Financial Market Rescue – The U.S. Federal Reserve (the Fed), trying to avoid a major bank collapse, approved a \$30 billion credit line to help JPMorgan Chase buy Bear Stearns and launched a lending program for Wall Street's biggest investment firms. Shortly before these moves, the Fed had announced a \$200 billion loan program, but the credit markets didn't respond.

July 2008: Housing Legislation – President Bush signed a vast housing bill that attempted to prop up Fannie Mae and Freddie Mac, the nation's two largest mortgage finance companies, as well as prevent 400,000 mortgage holders from losing their homes.

The bill includes roughly \$15 billion in housing-related tax breaks and almost \$4 billion in grants for local governments to buy and refurbish foreclosed properties. The bill also raised the national debt ceiling by \$800 billion, to a total of \$10.6 trillion.

September 2008: AIG Rescue – The Fed approved an \$85 billion bailout of American International Group, fearing a massive chain reaction if the insurance giant were allowed to fail. In the months to come, AIG would receive tens of billions more in taxpayer money.

October 2008: TARP, Round 1 – The Bush administration proposed, and Congress approved, the \$700 billion Troubled Asset Relief Program, sometimes referred to as the "bank bailout." Congress allocated the funds in two rounds of \$350 billion each – the first in October 2008, and the second in January 2009.

Under President Bush, the first round of funds was primarily used to buy shares of financial companies. This direct-investment strategy was a reversal of the Bush administration's original plan to buy financial companies' "toxic assets" – loans and mortgage-backed securities that have plunged in value and are weighing down banks' balance sheets.

Questions quickly arose about how the banks were spending the bailout funds – it appeared banks were shoring up their own balance sheets, rather than making new loans to businesses. Critics also questioned how homeowners would ultimately benefit by the government's purchase of financial company shares.

Additionally, General Motors and Chrysler received billions in emergency loans.

January 2009: TARP, Round 2 – Congress released the second half of the TARP funds in January. The world waited to see what plans the Obama administration would unveil, and some financial companies that received previous TARP funds came back for more.

The next month, Treasury Secretary Timothy Geithner sketched a rough outline of an economic plan, including aid for homeowners and expansion of a \$1 trillion consumer and business lending initiative called the Term Asset-Backed Securities Loan Facility (TALF). TALF does not provide loans directly to businesses or consumers, but is designed to increase the credit available to them through the asset-backed securities (ABS) markets. The ABS markets historically have funded a substantial share of credit to consumers and businesses, but have been under strain in recent months.

He also outlined plans for a public-private partnership to buy toxic assets, but was excoriated for a lack of detail. The Dow Jones Industrial Average (Dow) fell 4.6% for the day. Source: Dow Jones. (An investment cannot be made directly in an index.)

February 2009: Another Economic Stimulus – President Obama signed the American Recovery and Reinvestment Act of 2009 – a \$787 billion economic rescue package that includes \$212 billion of tax relief, \$308 billion of appropriations and \$267 billion in direct spending. Spending highlights include investments in infrastructure and energy efficiency. The Obama administration estimates that the stimulus will create or save 3.5 million jobs by the end of 2010.

February 2009: Another Housing Rescue – The day after he signed his economic stimulus package, President Obama announced a \$75 billion plan to help struggling homeowners, including a loan modification program that could lower mortgage payments for borrowers in danger of foreclosure. Additionally, the package provides \$200 billion for Fannie Mae and Freddie Mac, in hopes the additional funds would increase the credit available for mortgages.

March 2009: Taking on Toxic Assets – On March 23, the Obama administration announced the details of its plan for tackling the toxic assets that are weighing down banks' balance sheets. These assets include real estate loans held directly on the banks' books, as well as securities backed by loan portfolios.

The Treasury Department, in partnership with the Federal Deposit Insurance Corporation (FDIC) and the Fed, is creating the Public-Private Investment Program (PPIP). PPIP will use \$75 billion to \$100 billion in TARP funds, along with money from private investors, to buy these toxic assets. PPIP plans to initially buy \$500 billion in assets, with the potential to expand to \$1 trillion over time.

On top of that, the Treasury Department plans to expand the \$1 trillion TALF lending initiative to finance the purchase of existing mortgages and mortgage-backed securities.

All told, the government's various plans could result in the purchase of up to \$2 trillion in assets.

Investors' initial reaction was enthusiastic. On the day of the PPIP announcement, the Dow closed nearly 6.8% higher. Whether this enthusiasm signals support for the plan – or simply relief that details are finally emerging – remains to be seen.

Going Forward: A Bigger TARP? – Of the \$700 billion in TARP funds, \$35.2 billion remained unallocated as of April 9.

President Obama has not requested additional funds from Congress, but in his 2010 budget, he raised the possibility that an additional \$750 billion in asset purchases may be required to stabilize the economy. He suggested that the government could recoup two-thirds of its investment on these assets, with a net cost to the government of \$250 billion.

The budget text emphasized that the future costs of financial stabilization are difficult to predict, and that the \$250 billion is a placeholder figure – similar in spirit to the budget's placeholder for the future costs of war.

Conclusion

As long as this list may be, it still doesn't cover everything that the federal government is doing to back up the economy. For example, the government has taken steps to strengthen money market funds by guaranteeing money market deposits through a \$50 billion fund, and by facilitating sales of money market instruments in the secondary market (through the Money Market Investor Funding Facility).

It's likely that over time, the list of government economic initiatives will become even longer. To fully assess any plans that come in the future, it will be important to remember what programs have come before.

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