Governments Expand Financial and Economic Rescue Efforts

Robust Response a Sharp Contrast to the Great Depression

By Dirk Hofschire, CFA

The financial crisis has deepened and expanded in recent weeks, reaching what appeared to be a panic in the short-term credit markets. This turmoil has impacted the real economy, as even non-financial businesses have struggled to obtain funding required for their day-to-day operations. The knock-on effects of tighter credit are already being felt throughout the world, resulting in a banking crisis in Europe and dramatically deteriorating prospects for the outlook for global economic growth over the next several months.

Frenzied Pace of Government Policy Response

During the past two weeks, there has been a flurry of government announcements declaring new actions targeted at stemming the global financial crisis (see Exhibit 1, page three). The number, scope and monetary amount of the actions are unprecedented in modern times. The number of countries involved in major new initiatives has jumped in recent days, as the geographic scope of the crisis has expanded throughout the globe. These governments are fighting battles on several fronts. They have announced or implemented plans to inject capital into banks, provide liquidity and guarantees to distressed short-term credit markets, expand protection for bank deposits, purchase troubled assets to remove them from the balance sheets of lending institutions, and cut interest rates. The combined value of these operations and guarantees is probably more than $2 trillion and rising.

The Major New Initiatives Include:

- Direct infusions of capital into major banks in return for equity stakes in the companies, announced by the governments of the U.S. and the five largest European economies. This includes the U.S. announcement that it will use the authority and $250 billion of the $700 billion granted in the Emergency Economic Stabilization Act rescue legislation for this purpose. This is the most direct manner to boost the depleted capital positions of banks—a key ingredient to restoring confidence in the health of financial institutions.

KEY TAKEAWAYS

- The financial crisis has deepened and expanded in recent weeks, with the knock-on effects of tighter credit increasingly weighing on global economic growth.

- A flurry of government actions targeted at stemming the global financial crisis have been announced in recent days, reaching a scope and monetary amount that is unprecedented in modern times.

- The response has been increasingly global, as financial authorities around the world have announced direct capital injections into banks, guarantees of bank debt, and interest rate cuts aimed at helping their struggling financial systems.

- The accelerated pace and scope of government activity is a sharp contrast to the initial response during the 1930s, when it took the U.S. government more than three years to address a widening banking and economic crisis.

- The U.S. government is not repeating the policy mistakes of the Great Depression, and its actions represent part of the solution that should eventually stabilize confidence, the financial system and the economy.
Guarantees of bank debt, aimed at alleviating distress in the inter-bank lending markets, announced by the governments of the U.S. and the largest European economies.

Interest rate cuts by at least 12 central banks around the world, including coordinated easing on October 8, 2008, by the governments of the major economies including the U.S. Federal Reserve and European Central Bank.

Additional government intervention in the European and U.S. banking systems, including the expansion of bank deposit guarantees in several countries.

A new Federal Reserve facility to directly purchase commercial paper, in an effort to supply short-term lending to companies who are struggling to fund their operations as a result of tightened credit conditions for short-term funds.

Commentary
The fact that such costly and ambitious government efforts to counter the financial crisis are necessary speaks to the seriousness of the situation. The global economy faces the prospect of a severe economic downturn, and each day that the world financial system has remained in turmoil has exacerbated the severity of the economic impact. The list of government policy responses around the world is likely to expand in coming days, weeks and months.

Despite the deteriorating conditions and dire predictions, we are not currently in any sort of economic environment resembling the Great Depression.

The accelerated pace and scope of government activity raises the potential to mitigate the economic damage—unlike what happened during the 1930s. After the stock market crash of 1929, it took the U.S. government nearly three-and-a-half years to respond vigorously to the crisis with the New Deal legislation in 1933. While the U.S. economy slogged through a devastating banking panic and economic downturn from 1930-32, the Federal Reserve made no significant response and the U.S. government raised tax rates and tariffs, offering little aid and even some counter-productive policies.

In contrast, today, one year into this credit crisis and perhaps only one month into a clear global economic downturn, the Federal Reserve and U.S. government have responded with far-reaching actions. Some of these programs, including key portions of the rescue legislation, have yet to be fully implemented. But the U.S. government is not repeating the policy mistakes of the Great Depression, and they have been joined by their global counterparts. The government response will take time to work, will be costly, and will not prevent the economy from going into recession. Adroit oversight will be required to ensure the government does not prop up insolvent institutions, and a speedy unwinding of the government role will be necessary after stabilization is achieved. However, the actions by governments around the world represent a significant part of the solution that should eventually stabilize confidence, the financial system and the economy.

Editor's Note: See next page for a list of recent government actions to stabilize the global financial system.
EXHIBIT 1: During the past two weeks, the sprawling global financial crisis has prompted massive government intervention throughout the world.

<table>
<thead>
<tr>
<th>Two Weeks of Government Policy Responses (as of October 14, 2008)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Broad Rescue Packages</strong></td>
</tr>
<tr>
<td>The governments of the U.S. and the five largest European economies (the U.K., Germany, France, Spain and Italy) announce they will inject capital directly into banking institutions in return for equity stakes, including U.S. plans to use $250 billion of the $700 billion authority from the rescue legislation.</td>
</tr>
<tr>
<td>The governments of the U.S. and the five largest European economies announce guarantees of short-term bank debt designed to bolster confidence in the inter-bank lending markets.</td>
</tr>
<tr>
<td>Federal Reserve announces creation of Commercial Paper Funding Facility (CPFF) to purchase unsecured and asset-backed commercial paper from qualified borrowers.</td>
</tr>
<tr>
<td>U.K. becomes first to announce broad bank bailout, which includes expansion of liquidity facilities*, a guarantee of new and medium-term bank debt, and £50B in capital for bank preferred stock.</td>
</tr>
<tr>
<td>U.S. Congress passes Emergency Economic Stabilization Act (includes $700B** for Troubled Asset Relief Program -TARP).</td>
</tr>
<tr>
<td>Federal Reserve expands U.S. dollar swap programs with other foreign central banks to $620B.</td>
</tr>
<tr>
<td>Federal Reserve expands existing liquidity facilities* to financial institutions.</td>
</tr>
<tr>
<td>U.S. Treasury opens money market funds guarantee program.</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

* Liquidity and liquidity facilities in the table above refer to government or central bank programs constructed to replace assets (generally in the form of fixed income securities) with cash or cash equivalents. Liquidity generally refers to the ability of a business to meet its payment obligations (via sufficient liquid assets); an asset’s liquidity is defined by its ability to be transformed into another asset without loss of value. ** B: billions.

Note: The above policy actions are representative of recent efforts, and are not intended to be an inclusive list of actions on behalf of all governments worldwide.


Interest rate cuts by central banks:
- United States
- European Central Bank
- Taiwan
- Korea
- Hong Kong
- Australia
- Canada
- Switzerland
- China
- Sweden
- New Zealand

Lower bank reserve ratio requirements:
- China
- India
- Pakistan
- Indonesia

---

The Market Analysis, Research and Education (MARE) group, a unit of Fidelity Management & Research Co. (FMRCo.), provides timely analysis on developments in the financial markets.

*Investment decisions should be based on an individual’s own goals, time horizon, and tolerance for risk.*