The Fed cuts rates in emergency move

The Fed cuts rates by 50 basis points. It signals it is prepared to do more should the coronovirus spread further. We expect a further 50bp of cuts by the end of the second quarter

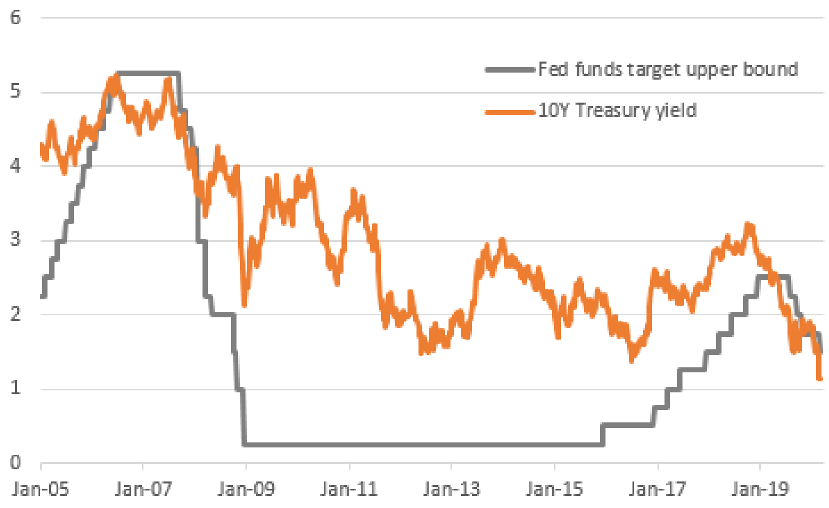
Source: Shutterstock

Friday's statement that the Federal Reserve is "closely monitoring" developments and stands ready to "use our tools and act as appropriate to support the economy" indicated that action was coming and the Fed has just delivered a 50bp rate cut. The decision follows a 7:00am ET call between the G7 Finance Ministers and central bank heads that initially underwhelmed with little sign that coordinated action was going to be forthcoming.

The brief accompanying statement acknowledges that while economic fundamentals "remain strong… the coronavirus poses evolving risks to economic activity". The FOMC is "closely monitoring developments and their implications for the economic outlook and will use its tools and act as appropriate to support the economy".

We doubt today's policy action will trigger a meaningful boost to aggregate demand, but implementing rate cuts may help to mitigate some potential strains in the financial system and give a lift to sentiment.

Fed funds target rate vs 10Y treasury yield



Source: Macrobond, ING

The Coronavirus outbreak started out as a supply chain shock for the US due to disrupted supply chains as factories closed in China and other parts of Asia. However, over the past couple of weeks it escalated into a financial shock as markets recognised Covid-19 was going to have a much broader impact on the global economy. The concern now is that the fear factor surrounding Covid-19 will change corporate and consumer behaviour and lead to a demand shock as well. This is most likely through the service sector of the economy with travel, hotel accommodation, restaurants and leisure-related sectors looking vulnerable. Add in the prospect of significantly weaker export performance and a negative second quarter GDP print is looking a distinct possibility.

Given the uncertain outlook for the path of the virus most governments are advising the situation is likely to deteriorate before hopefully easing over the summer. With economic activity likely to be significantly impacted and inflation set to fall pretty sharply – energy prices are set to plunge on oil while core inflation will likely edge lower as weaker demand offsets the supply shock - we are pencilling in two further 25bp rates cuts for 2Q giving a total of 100bp of easing.

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