

## Federal Reserve: All in... they certainly are!

Our Fed preview had a lifespan of roughly three hours, but we seemingly called it right with a 100 basis point rate cut and a formal restart of quantitative easing



Source: Shutterstock

### 100bp rate cut and US\$700bn QE

The Federal Reserve has announced that it is cutting the Fed funds target rate 100bp to 0-0.25% with immediate effect on the basis that Covid-19 is disrupting global economic activity and has significantly affected global financial condition. It has promised to keep rates there “until it is confident that the economy has weathered recent events”.

[We had expected such an outcome](#) but thought they would wait until the scheduled Wednesday meeting. However, with the news flow on the virus getting worse and the economic disruption set to intensify, the Fed clearly thought it prudent to get out ahead of the market open tomorrow.

The supply crunch in manufacturing, the panic in the financial sector and the collapse in airline travel, hotel stays and leisure activities means we could see a quarterly contraction of the scale reached during the height of the financial crisis, especially with the prospect of some city lockdowns. We are pencilling in an 8% annualised 2Q20 GDP decline relative to the -4.4% figure

experienced in 1Q09 and -8.4% in 4Q08.

The Fed has also announced it is formally restarting QE by promising to buy US\$500bn of Treasuries and US\$200bn of mortgage-backed securities “over coming months”. We also expected then to restart QE, but anticipated that they would begin with around US\$75bn per month. By giving a more general end-target they have more flexibility to front-load or respond to any market dislocation as necessary.

It is worth noting that the Federal Reserve’s balance sheet peaked at US\$4.5 trillion in early 2015 – equivalent to around 25% of US GDP. Today the balance sheet is around US\$3.8 trillion or 18% of GDP. The Fed would have to expand its balance sheet by around US\$1.6 trillion to get us back to a 25% of GDP today, so when you look at it that way the Federal Reserve has more ammunition up its sleeve.

Rounding out the releases, the Fed has also announced in coordination with the ECB, BOE, BOC, BOJ and SNB central banks a “coordinated action to enhance the provision of liquidity via the standing US dollar liquidity swap line arrangements”. The purpose being to ease strains in global funding markets that could, if not dealt with, hurt the supply of credit to households and businesses.

This action in itself is not going to rescue the US economy from recession, but it will help to mitigate the risks from financial tensions that could make the growth and jobs outlook far, far worse. It will also offer breathing room before an anticipated fiscal stimulus and a potential lending scheme provided by the Treasury materialise. That said, only better news on the prognosis for Covid-19 will return us to “normality”. Like most, we hope this will be over by the summer, but the Fed cannot take that for granted and consequently this justifies an aggressive response that can always be reversed.

## Author

### James Knightley

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. (“ING”) solely for information purposes without regard to any particular user’s investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.