The Fed's Strengthened Security Blanket Met By Falling Equities

- **Emergency Fed meeting results in major stimulus measures**
- **The Fed applied eight easing measures…**
- **…as it responds to signs that key markets were not functioning properly…**
- **...as opposed to a specific liquidity event**
- **Fed funds cut 100bps to 0–0.25%; negative rates dismissed**
- **Strong forward guidance issued**
- **Primary credit discount rate slashed to 0.25%, lower than during the GFC**
- **Moral suasion encourages banks to borrow, reducing stigma effect**
- **"At least" $500B of Treasuries and $200B of MBS to be purchased**
- **Swap lines reactivated at lower rates with BoC, BoE, ECB, BoJ, SNB**
- **NY Fed reaffirms continued repo activities**
- **Reserve requirements reduced to 0%**
- **Powell skirted around recession risk**
- **Today's unscheduled meeting is in lieu of this week's**
- **RBNZ cuts, RBA injects liquidity, BoJ announces emergency meeting**
- **Be on watch for possibility of further BoC easing**

The Federal Reserve introduced a series of decisive actions to ensure that the financial system continues to function properly but the efforts did not calm markets in early Asian trading. The measures pull out many of the stops that we anticipated in this earlier note—and then some! The effects are already reverberating across other foreign central banks and we will be monitoring prospects for further action.

US equity futures were down by 4½% shortly after the decisions were communicated as Asian markets opened but they quickly hit limit down. The Nikkei is down by over 1% so far. Oil prices are down by 2% (WTI) and over 3% (Brent). The USD is depreciating by over 1% on a DXY basis thus far.

POLICY MOTIVATIONS

It is important to emphasize with clients that the goal here is not to necessarily remove further downside risk to risk assets, but to ensure the proper functioning of the financial system. Measures like this should succeed in doing so in my view and that's the best thing monetary policy can achieve on its own. During his press

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conference, Powell was right to emphasize the roles played by health practitioners and fiscal policy to control the spread of the COVID-19 virus and to inject targeted support to households and firms.

Further on the motivations, note that when asked in the press conference, Chair Powell seemed to lean against any tendency to interpret today's actions as having been triggered by a particular event or expected event, such as a major form of systemic risk. That doesn't necessarily negate the possibility notwithstanding that the Fed would be unlikely to advertise it, but Powell emphasized that they saw the low take up rates on the expanded repo activity they introduced at the end of last week and concluded they had to take more aggressive and more direct steps. What worried them over the past few sessions were signs that the Treasury and MBS markets were not functioning properly and that's what motivated them to step in today within the confines of their powers.

When probed about recession risk as a possible motivator, Powell did not dismiss the possibility (nor should he have…). He noted that "we have a range of views on the economy" and that in general the US economy was in a strong position before the virus. Powell guided that Q2 will be weak, but it's very hard to say how big the effects will be and how long they will last while its "unknowable" how the virus will proceed. Powell reemphasized how in the meantime, the Fed will use its tools to support the financial system and ensure a recovery. Nevertheless, a shock to growth—howsoever transitory—coupled with Powell's guidance that the Fed views this shock as more of a disinflationary demand shock than a supply shock—provides ample motivation to ease policy. The breadth of the measures is, however, clearly more guided toward addressing financial system functioning rather than a baseline view on how the COVID-19 virus may impact the economy.

I think these measures should dramatically help with the proper functioning of the broad financial system and ease financial conditions.

AN EIGHT-STEP PLAN

The Fed issued three statements (here, here and here) to explain the following eight measures and the New York Federal Reserve issued four statements (prime one here including embedded links to three others with market-specific desk details). The FOMC also indicated that it is prepared to go further if needed and to use its full range of tools.

1. It cut its fed funds policy target range by 100bps to 0–0.25%. That is roughly in keeping with what markets had anticipated for this Wednesday's scheduled but now pre-empted meeting. When asked during the press conference where negative rates were possible, Powell poured cold water on the notion by emphasizing how they were not pursued in the GFC and the strategic review of policy options has not viewed negative rates as a favourable tool in the US.

2. It issued strong forward guidance that it will maintain this policy rate range "until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals."

3. The Fed aggressively lowered the primary discount rate by 150bps to 0.25% That's more aggressive than during the GFC when the floor was set at 0.5% even when the fed funds target range was also cut to 0–0.25%, but it still lowers the rate by 150bps which strongly incentivizes borrowing at the window.

4. The Fed took pains to reduce the stigma attached to borrowing from the Fed by using its tool of moral suasion to encourage banks to borrow on improved terms at the window. The Fed will allow banks to borrow from the discount window for up to 90 days with the same collateral.

5. The Fed issued a commitment to buy at least $500B of Treasuries over the coming months and to cease all run-off of securities from the existing book. It will also buy at least $200B of agency MBS over coming months and immediately cease the run-off of these securities in its portfolio. They will start buying tomorrow but with no weekly or monthly cap over time versus being guided by market conditions. The New York Federal Reserve issued this statement including additional links to further desk details. Starting tomorrow, the NY Fed will buy US$40 billion in nominal coupon securities and TIPS with subsequent purchases 'as appropriate' to ensure proper market functioning and across a range of maturities. The NY Fed will also begin MBS purchases tomorrow and concentrate upon purchases of 30 year and 15 year fixed rate agency MBS in the to-be-announced market. They guided that they expect to buy around US$80B in agency MBS through to April 13th including US$23 billion in purchases to reinvest principal payments from agency debt and agency MBS expected this month.

6. The NY Fed also guided that repo operations will continue to be offered for "at least US$175 billion" in overnight repo each day, "at least" US$45 billion in two-week term repo twice weekly. And US$500 billion in one month term repo and US$500B in three-month term repo weekly.

7. The Fed joined with the BoC, BoE, BoJ, ECB and SNB to reduce pricing on standing US dollar liquidity swap lines by 25bps. The new rate will be the US$ OIS rate +25bps. Central bank counterparts will begin offering weekly 84 day loans in addition to prior one-week maturity operations to take effect this week. In turning back toward swap lines with 5 counter parties, the aim is to address strains in USD funding pressures. The aim is to provide other central banks with enough USD funding for their own financial systems and borrowers given the key reserve currency status of the USD across global financial markets. Basically, the world was just granted unlimited dollar funding at a cheaper price.

8. The Fed reduced reserve requirements to 0% effective March 26th. This should incentivize lenders relative to what would have otherwise been the case, but they still need solid clients to lend to.

There was only one dissenter (Mester) and it was a token dissent in that she supported all measures but wished to the fed funds target range decline by 75bps instead of 100bps.

Today's unscheduled meeting and measures are in lieu of the meeting that was scheduled for this Tuesday and Wednesday. The FOMC was scheduled to issue forecasts this week but will not issue new forecasts until June. Powell stated "there is no sense" in making forecasts now. I wonder if our clients would accept the same logic!

SPILLOVER EFFECTS

Given the implications for their own currencies and relative rates, be on guard for other foreign central banks to announce further measures. In fact, it's already occurring.

The RBNZ slashed its policy rate by 75bps to 0.25%. The Bank of Japan has called an emergency meeting at noon local time.

The RBA immediately injected extra liquidity into markets.

Further, while the series of Fed moves may further illuminate the rush by Canada to offer stimulus on Friday given communications between central banks were likely well underway on swap lines. This action also further raises the possibility of another 50bps reduction in the BoC's overnight borrowing rate in an intermeeting move.