CURRENT MARKET NEWS

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On the morning of March 3 the Federal Reserve announced an emergency rate cut of 0.5% (target range of 1% to 1.25%) in response to concerns around the spread of the coronavirus, formally known as Covid-19. The move followed a call between Fed Chairman Jay Powell and other leaders of G-7 economies to discuss developments with the virus and the potential economic fallout. Chairman Powell hinted that other central banks may respond as well to ease financial conditions following the market selloff that occurred during the previous week along with an uncertain economic path ahead.

Emergency rate cuts are a relatively rare event, with the last one occurring in October 2008 during the heart of the Financial Crisis. Given the rapid nature of the COVID-19 news flow both here and abroad, the Fed felt it necessary to cut rates immediately rather than wait a mere two weeks until their next scheduled meeting. This action demonstrates the proactive nature of the Fed in their effort to prolong the U.S. economic expansion in the face of a new threat to growth.

Stock markets initially cheered the rate cut before sinking back. In his press conference, Chairman Powell said the rate cut will provide meaningful support to the economy via more accommodative financial conditions along with boosted business and consumer confidence. The bond market, however, had already priced in this move by the next Fed meeting, so investors were largely prepared for a Fed policy response. The accommodative Fed policy – and market expectations for more cuts – has driven down Treasury yields and kept borrowing rates quite low for businesses and consumers, although credit spreads have been widening in recent weeks. We will be watching the health of credit markets closely to gauge the impact of COVID-19 on the real economy.

We are encouraged to see the Fed step in to support the market, especially considering the equity selloff and credit weakness that occurred during the previous week. However, rate cuts are a blunt instrument not well suited for an issue as complex as the COVID-19 outbreak we are currently experiencing. An accommodative Fed is one important piece of the policy response to help support markets but the economic boost will be limited. While fiscal policy is typically slow and unwieldy, markets will likely want swift and concrete action from policymakers on that front to blunt the economic drag necessary to contain COVID-19.

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