On a Sunday, The Fed Cuts Rates to Near Zero

The ninth surprise rate cut in history is the second due to the Coronavirus

In a dramatic and emergency action to support the U.S. economy during the coronavirus pandemic, the Federal Reserve announced it would cut its target interest rate to near zero. And it announced it on a Sunday.

While the Fed was scheduled to meet on March 18th and the markets expected this rate cut to happen then, it was surprising that the Fed decided they couldn't wait even 3 more days (the Fed won't be meeting afterall on the 18th either).

The unexpected and faster-than-expected rate cut is on the heels of the Fed's emergency 50 basis points rate cut on March 3rd – and that cut was the first time since October 2008 that our central bank decided to go ahead with a cut in between scheduled policy meetings.

The Fed's Tools

In addition to short-term rate cuts, the Fed is doing more to prop up the economy, including:

- The Fed will purchase $700 billion worth of Treasury bonds and mortgage-backed securities
- The Fed brokered a deal with other global central banks to lower their rates on currency swaps to bring normalcy to markets. The other central banks include the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and the Swiss National Bank

In a prepared statement, Federal Reserve Chairman Jerome Powell justified the rate cut and said:
"We will maintain the rate at this level until we're confident that the economy has weathered recent events and is on track to achieve our maximum employment and price stability goals."

Transcript of Chairman Powell's Remarks

Released by the Federal Reserve concurrent with Powell's press conference:

"The coronavirus outbreak has harmed communities and disrupted economic activity in many countries, including the United States. Global financial conditions have also been significantly affected. Available economic data show that the U.S. economy came into this challenging period on a strong footing. Information received since the Federal Open Market Committee met in January indicates that the labor market remained strong through February and economic activity rose at a moderate rate. Job gains have been solid, on average, in recent months, and the unemployment rate has remained low. Although household spending rose at a moderate pace, business fixed investment and exports remained weak. More recently, the energy sector has come under stress. On a 12-month basis, overall inflation and inflation for items other than food and energy are running below 2 percent. Market-based measures of inflation compensation have declined; survey-based measures of longer-term inflation expectations are little changed.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The effects of the coronavirus will weigh on economic activity in the near term and pose risks to the economic outlook. In light of these developments, the Committee decided to lower the target range for the federal funds rate to 0 to 1/4 percent. The Committee expects to maintain this target 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. This action will help support economic activity, strong labor market conditions, and inflation returning to the Committee's symmetric 2 percent objective.

The Committee will continue to monitor the implications of incoming information for the economic outlook, including information related to public health, as well as global developments and muted inflation pressures, and will use its tools and act as appropriate to support the economy. In determining the timing and size of future adjustments to the stance of monetary policy, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective. This assessment will take into account a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments.

The Federal Reserve is prepared to use its full range of tools to support the flow of credit to households and businesses and thereby promote its maximum employment and price stability goals. To support the smooth functioning of markets for Treasury securities and agency mortgage-backed securities that are central to the flow of credit to households and businesses, over coming months the Committee will increase its holdings of Treasury securities by at least $500 billion and its holdings of agency mortgage-backed securities by at least $200 billion. The Committee will also reinvest all principal payments from the Federal Reserve's holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities. In addition, the Open Market Desk has recently expanded its overnight and term repurchase agreement operations. The Committee will continue to closely monitor market conditions and is prepared to adjust its plans as appropriate."

A Little History

By most accounts, this is just the ninth surprise rate cut by the Fed since the end of the 1994 and some of the other surprise cuts came during equally troubling times, including:

- The height of the financial crisis in 2008
- The start of 2001 (think dot.com bubble bursting)
- In 1998 when Long-Term Capital imploded

Now we can add two surprise rate cuts due to the coronavirus to that list.

Consumer Impact

Although the Fed Funds rate is what banks charge one another for short-term borrowing, it will still impact consumers, including:

- Credit Cards – most have a variable rate tied to the Fed's benchmark rate, so cardholders are likely to see a reduction in their annual percentage rate
- Student Loans – the government sets rates once a year based on the 10-year Treasury and if the 10-year stays at historical lows, loans for next year and beyond could be much lower
- Bank Savings Rates – they were paltry to begin with and now they will be almost non-existent
- Mortgages – they are also more pegged to Treasury notes, especially the 10-year and like Student Loans, could be lower next year too.