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US Federal Reserve fires on all cylinders

Yesterday the US Federal Reserve congregated in order to provide emergency support to a financial system reeling from the relentless spread of coronavirus which is now present in 158 countries. Spain — like Italy and France to varying degrees — is now on lockdown, and risk assets are falling even further on fears about the economic impact.

The contents of the stimulus package were:

- A cut in the main fed funds rate by 100 basis points (bps), taking it back to its crisis-era range of 0.0% and 0.25%

The
Fed "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". In other words, rates could remain at this level for a lot longer, if the Fed intends to wait until inflation converges back towards its 2% target.

- Renewed Quantitative Easing

The
Fed will buy at least $500bn of Treasury securities and at least $200bn of agency MBS (mortgage-backed securities). Buying will begin with $40bn of Treasury securities on Monday.

- The penalty rate on the discount window was cut by 150bp to 0.25%

This
is an attempt to encourage banks to use the window to secure funding if needed. The Fed stated its support for commercial banks willing to use their capital buffers to extend credit to households and businesses and scrapped reserve requirements.

- The cost of dollar liquidity swaps offered via other central banks was halved.

This should
ease funding market stress by supporting the dollar funding requirements of banks overseas.

In essence, the Fed has gone all in, attempting to prop up the financial system and keep credit flowing to affected businesses and households. The action is probably in place of what was planned for the Monetary Policy Committee on Wednesday, although we cannot be sure.

At a previous emergency meeting on March 3rd, the US central bank already slashed interest rates by 50 basis points and announced liquidity provisions of $175 billion in overnight repos and $45 billion in two-week operations. The New York Fed offered $500 billion in a three-month repo operation and said it would repeat the exercise Friday, along with another $500 billion in a one-month operation, and continue on a weekly basis for the rest of the monthly calendar. This was not enough to console markets.

Analysts have grown anxious that even aggressive monetary easing will only go so far in softening the economic blow of coronavirus and many are calling for fiscal spending in order to somewhat offset the demand-side shock to the economy. The fear now is that central banks are losing their firepower and despite the Fed's 'all in' stance, European stocks tumbled further on Monday and futures on the S&P 500 index fell as much as 5% triggering exchange circuit breakers. The G7 is having a conference call this evening which could lead to further fiscal spending.

Nonetheless, central banks continue on the front line for now: The Bank of Japan on Monday followed the Fed's actions by announcing it aimed to double its purchases of exchange traded funds to ¥12tn ($112bn) a year. Meanwhile, China's central bank injected about Rmb100bn ($14.3bn) of liquidity into financial markets via its medium-term lending facility.

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