ANCHORAGE DAILY NEWS

Markets plunge despite Fed's emergency rate cut to stem coronavirus panic

Heather Long

March 3, 2020

WASHINGTON — The Federal Reserve on Tuesday took the emergency step of cutting the benchmark U.S. interest rate by half a percentage point, a large move aimed at limiting the economic and financial fallout from the coronavirus.

The U.S. central bank has not made an emergency cut like this since late 2008, shortly after the collapse of Lehman Brothers. Fed leaders said Tuesday's action was an effort to boost confidence in a time of deep uncertainty.

"We saw a risk to the outlook of the economy and we chose to act," Fed Chair Jerome Powell said at a press conference shortly after the rate cut announcement.

The Fed's action reduces the U.S. interest rate to just below 1.25 percent, down from about 1.75 percent. Fed leaders voted unanimously in favor of the rate reduction, and Powell tried to project a sense of calm during short 13-minute press conference. He said repeatedly that the U.S. economic fundamentals still look healthy, but he noted that "sentiment" had shifted.

The cut briefly calmed investors, but it was short-lived. The stock market fell sharply after his remarks.

The Dow Jones industrial average sank nearly 3%, or close to 800 points, and the yield on the U.S. 10-year Treasury bond - a foundation of global finance - briefly fell below 1%, before recovering slightly, as investors fled equities for the safety of bonds. Investors are worried that the spreading outbreak will upend the global economy and end the decade-long expansion.

"The Fed went a little early," said Jamie Cox, managing partner of Harris Financial Group. "Everybody knew the Fed was going to lower interest rates, but they left markets with a lot more questions than answers. That's why the early-morning bounce was quickly sold."

As the virus spreads, grocery store shelves are going empty in parts of the country, manufacturing supply chains are breaking down as parts aren't arriving from Asia, and businesses and households are cancelling cruises, conferences and flights at a rapid rate. The U.S. economy depends heavily on consumer spending, and there's growing concern that could nosedive as people stay home and watch the stock market's wild fluctuations.

The Fed typically likes to wait to see hard data signaling economic fires, but the coronavirus is moving so quickly that the central bank felt it needed to act ahead of a widespread situation where workers and students are forced to stay home and the economy grinds to halt.

Economists have warned that growth this year is widely expected to slow sharply and some countries could fall into a recession if the situation isn't resolved soon. Goldman Sachs has projected that economic growth in the United States could stall in the second quarter, which runs from April through June. Congress is preparing a $7.5 billion emergency funding package to help with the costs of fighting the epidemic.

President Donald Trump has called for for a "big" rate cut and a fresh tax cut to stimulate the economy. He criticized the Fed for not going far enough on Tuesday. But there are limits to what the Fed can do, especially with interest rates already so low and a shock to the economy that is causing people to want to stay home, regardless of how available cheap credit is.

"You are not going to slay a disease by lowering interest rates," said Bernard Baumohl, chief global economist at The Economic Outlook Group. He compared to the Fed's cut to "placing a Band-Aid on an arm to cure a headache."

Powell acknowledged the Fed can't come up with a vaccine or fix a broken supply chain that's disrupted by the outbreak in China, but he believes the rate cut will help protect the economy from a rapid downturn.

"We don't think we have all the answers, but we do believe our action will provide meaningful support to the economy," Powell said. "It will support accommodative conditions and avoid a tightening of financial conditions, and it will help boost household and business confidence."

As Powell spoke, the Dow initially rose 300 points and then fell sharply into the red, down nearly 500 points or close to 2 percent. While some worry that Powell caved to Trump, many economists and investors thought Powell made a mistake by not using his press conference to stress that the Fed would act again, if needed.

"The Fed's action today is better than nothing, but it's not quite what the doctor ordered," said George Selgin, a senior fellow at the Cato Institute and close Fed watcher. "Powell needed to give markets a more certain sense of the Fed's willingness to move rates further as necessary."

After the Fed made its announcement, Trump complained that the central bank had not done more. Wall Street is pricing in another cut by April.

"The Federal Reserve is cutting but must further ease and, most importantly, come into line with other countries/competitors. We are not playing on a level field. Not fair to USA. It is finally time for the Federal Reserve to LEAD. More easing and cutting!" Trump tweeted.

Powell left the door open to another rate cut when Fed leaders meet next for their regularly scheduled meeting on March 17-18, but he stopped far short of promising action. He once again dismissed the idea that the Fed is caving to Trump's wishes.

"We're never going to consider any political considerations whatsoever. And it's very important the public understands that," Powell said.

Many economists blame the White House and Congress for not doing more to help contain the crisis, thereby forcing the Fed to step in with its blunt instruments at a time like this.

"We need to know the extent of the virus in the U.S. We are not even doing broad-based testing. We don't know where this is or who has it. The uncertainty is so high right now about the most basic things and that's weighing on the economy," said Julia Coronado, a former Fed economist and founder of Marcopolicy Perspectives.

White House officials are considering a range of steps they believe could also address the economic unrest. Treasury Secretary Steven Mnuchin said Tuesday that the Trump Administration would consider an infrastructure package, tax cuts, regulatory relief for banks, and other steps if they felt it was necessary to help the economy.

In contrast to Trump, Mnuchin praised the Fed's action on Tuesday, telling Congress, "They did the right thing getting ahead of this...I applaud the Fed on this move."

The spread of the coronavirus began as a health emergency but has created extreme economic strain on multiple continents. Many experts say it is the biggest threat to the global economy since the financial crisis.

Earlier Tuesday morning, global finance ministers held a call to discuss global coordinated measures, but they stopped short of announcing any concrete steps, which sent markets downward. In the 2008 financial crisis, G-7 finance ministers announced "urgent and exceptional action" to bail out the banks.

"G-7 finance ministers are ready to take actions, including fiscal measures where appropriate, to aid in the response to the virus and support the economy during this phase," said a statement after the call. G-7 countries include the United States, Japan, Canada, France, Italy, Germany and the United Kingdom.

Trump had urged the Fed to quickly follow Australia's central bank, which cut interest rates in that nation to their lowest level ever.

"Australia's Central Bank cut interest rates and state it will most likely further ease in order to make up for China's coronavirus situation and slowdown. They reduced to 0.5%, a record low. Other countries are doing the same thing, if not more so. Our Federal Reserve has us paying higher rates that many others, when we should be paying less," Trump tweeted. The Fed "should ease and cut rate big."

Lowering interest rates would make it even cheaper to borrow money, but it would not address the root cause of concern in financial markets, which is the rapid spread of the virus to more than 60 countries.

In addition to Fed rate cuts, Trump also called for a one-year reduction in payroll taxes, which would be an immediate boost to the paychecks of working Americans. Payroll taxes are used to fund Social Security and Medicare and have been reduced in past times of economic trouble, including after the financial crisis.

While Democrats have been highly critical of the 2017 GOP tax cuts, some Democratic lawmakers might be open to payroll tax cuts, which would aid many working class Americans. About 75 percent of U.S. taxpayers do get assessed the payroll tax, according to the nonpartisan Tax Policy Center. Americans pay payroll taxes on income up to $137,700, so a cut would not have an impact on any income above that level.

Still, House Majority Leader Steny Hoyer, D-Md., dismissed Trump's call for a payroll tax cut when asked about it Tuesday.

"I don't think tax cuts are the answer to every problem," Hoyer told reporters.

But he left the door open to some sort of fiscal stimulus in the future if the economy falls deeper into peril due to the virus's spread.

"That may or may not be what we would do," he said of a potential stimulus, saying Congress would remain "focused on ... trying to keep the economy stable and growing and keep people employed,