Stocks Plunge Despite Fed’s Coronavirus Rate Cut

Andrew Soergel

March 3, 2020

THE FEDERAL RESERVE issued an emergency interest rate cut on Tuesday morning – a move ostensibly launched to steady financial markets following the worst week on Wall Street since the financial crisis.

But just a few hours later, the Dow Jones Industrial Average was down more than 900 points. The Standard & Poor's 500, similarly, was down more than 3.6% in midday trading. The Dow ended the day down nearly 800 points.

So why did Wall Street react so coldly to the Federal Open Market Committee's first inter-meeting interest rate reduction since the financial crisis?

In part, it's because investors had already anticipated the Fed's move. The Dow gained nearly 1,300 points on Monday for its best daily performance in more than a decade. Analysts attributed the strong day of trading to optimism that international central banks would step in to support the economy.

"While an easing of financial conditions is always desirable in times of economic and market stress, it is questionable as to what other benefits will be derived from this action," Chris Zaccarelli, chief investment officer at Independent Advisor Alliance, wrote in a research note on Tuesday. "Effectively the market demanded it because it was already priced into the Fed Funds futures."

Indeed, the CME Group's FedWatch tool – which tracks the odds of Fed interest rate adjustments in the eyes of analysts and investors – had already priced in a virtual 100% chance that America's central bank would slash interest rates by 50 basis points at or before the FOMC's March meeting.

When the Fed did just that on Tuesday morning, it wasn't news to investors, many of whom are now expecting at least two more 25-point rate reductions by the end of the year.

"Consequently, had the Fed not announced a cut, the decision would have amounted to disappointing news, which would have fueled further panic," George Selgin, a senior fellow at the Cato Institute, said in a statement.

Investors' nonplussed reaction may also stem from the fact that the Fed is limited in what it can do to fight a possible pandemic that has already sickened more than 90,000 people, killing more than 3,000. Although investors and President Donald Trump have clamored for Fed support to keep the economy humming in the wake, a reduction of interest rates won't keep people from getting sick.

"We do recognize that a rate cut will not reduce the rate of infection. It will not fix a broken supply change. We get that," Fed Chairman Jerome Powell said during a news conference on Tuesday, noting that the decision was designed to "support accommodative financial conditions" and "help boost household and business confidence."

Powell acknowledged that the Fed's rate reduction was launched in part to keep investors and consumers happy. But analysts were quick to point out on Tuesday that lower interest rates do little to quell the fundamental threat the coronavirus outbreak poses to international trade, travel, consumption and supply chain management.

"There is a nagging sense the emergency 50 basis point rate cut to support an economy that is battling the coronavirus is like placing a band-aid on an arm to cure a headache," Bernard Baumohl, chief global economist at the Economic Outlook Group, wrote in a research note. "One is hard-pressed to see how precisely this easing in monetary policy will effectively counter fears of getting ill from this pathogen."

Mark Hamrick, senior economic analyst and Washington bureau chief at Bankrate.com, also points out that the Fed didn't have much room to lower interest rates, considering they had not risen considerably off of their recession-era near-zero levels, and had in fact been lowered three times in 2019. He noted that "the Fed's most reliable ammunition, meaning lower rates, are dwindling."

"With the decision to move ahead with a proactive 50 basis point rate cut, the Fed may be pulling an impactless lever," Jason Reed, an economist, professor and assistant department chair of finance at the University of Notre Dame's Mendoza College of Business, said in a statement. "We can only hope the economy doesn't have to lean this much on the Fed, and that Congress and the White House can help mitigate the effects of this growing pandemic."