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Fed cuts interest rate half a percentage point, largest emergency cut since the financial crisis

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The Federal Reserve made an emergency interest rate cut Tuesday, slashing the benchmark U.S. interest rate by half a percentage point, the biggest cut since the financial crisis.

The U.S. central bank has not made an emergency move like this since late 2008, and economists say it signals that global central banks are prepared to act to contain the economic fallout from the coronavirus.

Fed leaders voted unanimously in favor of the rate reduction to help stabilize the economy and financial markets as the coronavirus spreads. The highly unusual action comes on the heels of other central banks around the world lowering their interest rates and calls by President Trump for a "big" Fed rate cut.

"The coronavirus poses evolving risks to economic activity. In light of these risks and in support of achieving its maximum employment and price stability goals, the [Fed] decided today to lower the target range for the federal funds rate by 1/2 percentage point," the Fed wrote in a statement.

The Fed's action reduces the U.S. interest rate to just below 1.25 percent, down from 1.75 percent. Fed Chair Jerome H. Powell plans to hold a news conference at 11 a.m. on Tuesday to discuss the rare move.

Stocks initially surged on the news, but the Dow Jones industrial average then slide back into negative territory, a reminder of how volatile the situation remains. Everyone from doctors to Wall Street traders are trying to get a handle on how much more the coronavirus will spread and how widespread the damage will be.

Trump took to Twitter to call for "more easing and cutting" by the Fed. He has said in the past that he wants negative interest rates, something that has never happened before in the United States and Powell has expressed a strong desire to avoid.

"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.

The last time the Fed made a move like this was after investment bank Lehman Brothers went bankrupt and the global banking system was at risk. The Fed has tried to downplay the risks now -- even calling the U.S. economy “strong” in its statement Tuesday -- but analysts remain on edge.

“Had the Fed not announced a cut the decision would have amounted to disappointing news, which would have fueled further panic,” said George Selgin, a senior fellow at the Cato Institute and close Fed watcher. “What matters most isn’t what the Fed has done today, but what actions it signals for the future.”

Rate cuts are the main way governments and central banks have in the past tried to address an economic downturn, but it’s uncertain how useful these tactics might be in the current crisis. Interest rates are already very low and it’s unlikely that people will want to go out and spend more money if they are concerned about catching the coronavirus. Cutting taxes is also unlikely to boost production if manufacturers can’t get the parts they need because of supply chain disruptions.

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. Trump and many investors have been urging major action to boost the economy. In a series of late night tweets, Trump called for interest rate cut by the Federal Reserve and a payroll tax cut for consumers.

Earlier Tuesday morning, global finance ministers held a call to discuss global coordinated measures and stopped short of offering to act, 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 released after the call among G-7 finance ministers and central bankers. G-7 countries include the United States, Japan, Canada, France, Italy, Germany and the United Kingdom.

Economists have warned that growth this year is widely expected to slow sharply and some countries could fall into a recession if world leaders do not act. 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.

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.”

Many economists agree with Trump that the Fed should act soon to reduce interest rates.

“If I were the Fed, I would already have been cutting rates," said Seth Carpenter, a former Fed economist who is now at UBS. “Last year the Fed did insurance cuts. If ever there was a time to do it, this is a time for insurance.”

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.

Some leading Democratic economic advisers have been urging the White House and Congress to consider a temporary payroll tax cut.

“One fast way to administer help is for the government to send checks to low- and middle-income households, a measure that was last used in 2008” during the George W. Bush administration, said economists Jared Bernstein and Dean Baker in a PostEverything piece. Bernstein was Vice President Joe Biden’s top economic adviser, and Baker is a senior economist at the left-leaning Center for Economic and Policy Research.

Treasury Secretary Steven Mnuchin visited Congress Tuesday and told lawmakers that a bipartisan infrastructure package could also be part of the economic response.

“If there’s a need to stimulate the economy as a result of the coronavirus, I’m sure infrastructure is a priority of the president,” Mnuchin said.