APOLLON
WEALTH MANAGEMENT

Fed Goes to Zero, Reboots Quantitative Easing

March 2020

In what shaped up to be a busy and sobering weekend for investors and concerned citizens alike, the Federal Reserve (The Fed) released a statement 3:00 p.m. (CDT) Sunday outlining three critical steps the Fed will take to support global financial conditions. Effective March 16:

1. The Fed will lower its target rate range from 1.00–1.25 percent to 0–0.25 percent, the equivalent of four -25 basis point rate cuts.
2. The Fed directed the Open Market Desk at the Federal Reserve Bank of New York to purchase $500 billion Treasury securities and $200 billion mortgage-backed securities (MBS) in the coming months. In contrast to prior quantitative easing policies, the Fed did not prescribe a target level of asset purchases per month. Instead it suggested “to conduct these purchases at a pace appropriate to support the smooth functioning of markets for Treasury securities and agency MBS.”
3. In coordination with other central banks, the Federal Reserve announced plans to re-open U.S. dollar swap lines to alleviate U.S. dollar-denominated funding stresses in foreign economies.

In its press release, the Fed acknowledged the effects of Coronavirus Disease (COVID-19) “harmed communities and disrupted economic activity in many countries, including the United States.” The Fed cited emerging stress in the energy sector and falling market-based inflation expectations as support for action and reiterated it intends to use all available policy tools to alleviate tightening financial conditions for households and businesses.

Though both critical and necessary to reduce individual and social impacts, domestic and international measures to slow the spread of COVID-19 are manifesting disruptions around the globe. In other words, corporations are likely dealing with abrupt declines in sales but fixed liabilities, causing a funding mismatch. To alleviate this mismatch, corporations rely on short-term borrowing or bank loans. Therefore, the Fed’s actions should provide modest relief to domestic corporations and augment support from the bipartisan legislation H.R. 6201: Families First Coronavirus Response Act, which is expected to pass in the Senate (as of Sunday, March 15).

For consumers, the monetary policy response appears mixed. According to the Federal Deposit Insurance Corporation, the national deposit rate on a 12-month CD (less than $100,000) was 0.46 percent as of March 9, but that rate is poised to head lower with the rate cut. Last time the Fed held interest rates near the zero-bound, the same deposit rate was 0.20 percent. The 30-year mortgage rate fell to 3.29 percent this month, in-line with levels observed in 2012, according to information from the Federal Reserve. Time will tell if household borrowing rates move lower in tandem with falling deposit rates as a result of the Fed rate cut.

We will continue to monitor developments of COVID-19 and its economic impacts as information becomes available. We advise clients to stay patient and stick to their strategic asset allocation.