WHATEVER IT TAKES

April 2020

Fed and Treasury Stand Ready To Do More If Needed

As expected, Federal Open Market Committee (FOMC) participants left the federal funds target range unchanged at 0.00 – 0.25 percent at its April meeting. During his press conference, Federal Reserve (Fed) Chair Powell stated the current accommodative policy stance would be in place until the Fed is “very confident” that an economic recovery is afoot. Today’s message was clear: the Fed will do whatever it takes to support households, small businesses and smooth functioning financial markets.

With little doubt the Fed would leave its rate policy unchanged at the April meeting, the Q&A portion of Powell’s (virtual) press conference centered on how the Fed would evaluate if more stimulus would be necessary to ride out the economic disruption caused by COVID-19. In short, he stated recently created policy tools were essential to support the function of markets and to help facilitate credit to the private sector by providing relief to the financial industry. It will take time for that relief to flow through the economic channels, but the Fed and U.S. Treasury Department are willing and able to expand all programs as needed.

Though he did not offer specific forward guidance, Powell said the Fed expects the next 12 months or so to be critical. The Fed’s base case outlook calls for “a sharp contraction in economic activity, high unemployment and a steep decline in consumption” over the next year. Policymakers will assess the effectiveness of its accommodative stance by monitoring labor market conditions, inflation indicators and expectations, as well as domestic and international financial developments. Powell stopped short of specifics but acknowledged that fiscal policy aimed at protecting small- and medium-sized businesses to mitigate the impact of long-term unemployment and accelerate the recovery would be beneficial. While specifics are difficult to predict, the ongoing need for mitigation efforts may soon warrant incremental fiscal stimulus for households and private businesses.

Since most investors anticipated the Fed’s rate decision and commitment to support financial markets, the market reaction was relatively muted. The S&P 500 Index closed the session up 2.7 percent on the day, and the U.S. 10-Year Treasury yield ticked up one basis point to 0.63 percent and just seven basis points above its March low.

Looking ahead, we will keep an eye on credit spreads, inflation expectations and U.S. dollar strength to assess the effectiveness of recent policy measures. U.S. equity volatility (VIX Index) remains a crucial barometer of investor sentiment and often grabs headlines, but oil volatility remains elevated. Time will tell if volatility in the oil market will seep into other asset classes before eventually normalizing.