Bracing for Zero

The coordinated effort by global central banks to ease monetary policy continues this week...for better or for worse. On Tuesday, the Reserve Bank of Australia cut the overnight cash rate by 25 basis points (bps) to 0.50%, the lowest in their history. Australian central bank officials reported:

“...the coronavirus outbreak overseas is having a significant effect on the Australian economy at present, particularly in the education and travel sectors. The uncertainty that it is creating is also likely to affect domestic spending. As a result, GDP growth in the March quarter is likely to be noticeably weaker than earlier expected. Given the evolving situation, it is difficult to predict how large and long-lasting the effect will be.”

(At the time of this rate cut, an estimated 29 people have been infected down under.)

On Wednesday, the Bank of Canada cut its overnight target rate by 50 bps to 1.25%. The first rate cut in more than four years was also in response to the spread of the coronavirus, which central bank officials believe represents a “material negative shock” to the Canadian and global outlooks. Although officials expect no further cuts in 2020, they stand ready to make additional adjustments as needed to support growth and keep inflation on target.

(At the time of this rate cut, less than 30 Canadians had been infected.)

Both the European Central Bank and the Bank of Japan have pledged to act as appropriate, although with key interest rates already negative, it’s difficult to envision policy actions that would provide any benefit.

Here in the U.S., the Fed is under pressure to cut more...and more. In the six other emergency Fed cuts enacted since 1998, additional easing moves of equal magnitude occurred in all but one instance at the next scheduled FOMC meeting. This suggests another 50 bps cut on March 18th. If history holds true, the Fed will have chopped the overnight funds rate by a full percentage point in a three-week period. The last time this happened was October 2008 while the financial crisis was raging.

Fed funds futures have now priced-in three more quarter-point cuts by the June meeting, with a 30% chance of a fourth. This essentially takes the overnight target back to zero. Just one week ago, Fed Vice Chairman Richard Clarida had indicated it was “still too early” to gauge the effect of the coronavirus and reported that “the current stance of monetary policy likely will remain appropriate.”

The two-year Treasury-note yield is currently trading at 0.57%. Eleven years ago, with rates at zero and the Great Recession in full bloom, the two-year was trading at 0.89%.

Tomorrow morning, the February employment report will be released. It’s too early to expect U.S. businesses will curtail hiring, but the virus effect on employment will most certainly have a negative impact in the coming months. A strong jobs number will be discounted, while a weak number is likely to reinforce concerns.

Please see disclosure on page 2.
Market Indications as of 2:05 P.M. Central Time

DOW                  DOWN 1033 to 26,058 (HIGH: 29,551)
NASDAQ            DOWN 285 to 8,733 (HIGH: 9,817)
S&P 500             DOWN 106 to 3,024 (HIGH: 3,386)
1-Yr T-bill current yield 0.47%; opening yield 0.60%
2-Yr T-note        current yield 0.59%; opening yield 0.69%
5-Yr T-note        current yield 0.68%; opening yield 0.78%
10-Yr T-note       current yield 0.93%; opening yield 1.05%
30-Yr T-bond      current yield 1.58%; opening yield 1.70%