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Waiting on Fiscal Policy as Aggressive Fed Move Falls Flat

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The FOMC surprised the markets for the second time in two weeks, this time with a 100 basis point inter-meeting cut on Sunday afternoon, effectively bringing the overnight rate target to zero. In addition, the FOMC reduced the interest on excess reserves (IOER) to 0.10% and will no longer require banks to adhere to a reserve requirement. The Fed is hoping banks will use freed-up capital to increase lending. Fed officials also slashed the discount rate from 1.75% to 0.25% (a new record low) and encouraged any bank facing short-term funding needs to access the discount window. Banks have historically been reluctant to borrow from the window as the practice has long been viewed as a sign of financial trouble.

The FOMC also pledged an additional $700 billion in asset purchases in a major relaunch of its quantitative easing campaign. The latest round of QE will include $500 billion in Treasury purchases and $200 billion in mortgage-backed securities. The Treasuries will be proportionally spread out along the maturity curve. All of those asset purchases will keep plenty of downward pressure on yields. Fed Chairman Powell provided forward guidance on Sunday indicating the committee expects to keep the rate target at zero "until it is confident that the economy has weathered recent events." In other words, the FOMC does not expect to reverse course any time soon.

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Since the Fed took preemptive action, the FOMC meeting, which had been scheduled for Tuesday and Wednesday, was called off. This means we'll have no summary of economic projections or "dot plot," showing the future rate expectations of committee members. Although at this point, it doesn't matter what the individual Fed members think. Things are evolving too quickly.

The stock markets gave yesterday's Fed action a resounding *thumbs down* today, indicating little confidence that monetary policy would have any effect on containing the virus. In all fairness, the emergency action was primarily intended to add liquidity to the financial system. Fiscal policy is what the markets are looking for. On this front, House Speaker Nancy Pelosi and Treasury Secretary Steve Mnuchin struck a coronavirus aid deal on Friday. The Senate is expected to vote on it later this week. Although it doesn't include the payroll tax cut Trump had mentioned, it is expected to provide funding through the Social Security Administration for workers forced to stay home who don't receive sick leave through their company. The bill also includes free COVID-19 testing, expanded unemployment insurance and increased funds for food stamps. The Fed's action might have been better received if announced in conjunction with a fiscal deal.

The monthly Bloomberg economist survey was released last week. Of the 54 responding, only three had expected the FOMC to reach zero by the March meeting. The number of economists forecasting a zero funds rate by the end of the second quarter grew to 16. So, it took just two days for the survey to become stale and all but three to be wrong. Some of the survey's highlights include slightly higher unemployment and slightly lower inflation in the coming months, and another significant downward revision to global GDP, which has now been lowered from +3.1% in January, to +2.9% in February to +2.5% in March. The median forecast for GDP in the U.S. shows a +1.4% annualized growth pace for the current quarter, dropping to +0.1% in the second quarter, before rebounding to +1.3% in the third. This seems very optimistic given the jaw-dropping weakness in the

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economic numbers emerging from China. Chinese industrial production fell -13.5% in February, while retail sales plunged more than -20%.

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Steven Mnuchin, on the Sunday talk show circuit, said although he sees a domestic slowdown ahead, he doesn't expect a full-blown recession. The Treasury Secretary is trying to project a positive outlook, but it's hard to imagine the U.S. economy actually growing while a broad swath of American life has been suspended. Unless signs of virus containment emerge very soon, economic contraction is the expected outcome. The longer major events and travel remained closed, the deeper the magnitude and duration of the recession. This is a consumer-driven economy, and we have curtailed spending on non-essential goods.

The U.S. got a late start on combating the virus and is now sprinting to catch up. COVID-19 test kits have been approved by the FDA and should be widely available this week. Thermo Fisher Scientific announced they expect to produce enough kits to test five million people a week. It's quite possible that increased testing will reveal a dramatic jump in the number of confirmed cases, but over time, as the infection rate diminishes, fears should subside. Until then, Fed support is critical in keeping the markets functioning while the fiscal plan is being approved. The markets are now focused on the Senate and approval of the aid bill.

Market Indications as of 3:25 P.M. Central Time

DOW	DOWN 2,997 to 20,188 (HIGH: 29,551)
NASDAQ	DOWN 970 to 6,905 (HIGH: 9,817)
S&P 500	DOWN 325 to 2,386 (HIGH: 3,386)
1-Yr T-bill	current yield 0.24%; opening yield 0.32%
2-Yr T-note	current yield 0.36%; opening yield 0.49%
5-Yr T-note	current yield 0.50%; opening yield 0.72%
10-Yr T-note	current yield 0.74%; opening yield 0.96%
30-Yr T-bond	current yield 1.32%; opening yield 1.53%