After zero

Fed special

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Summary

- In a 100 bps emergency rate cut the FOMC brought the lower bound of the target range for the federal funds rate back to zero yesterday. Loretta Mester (Cleveland Fed) voted against this decision because she wanted only a 50 bps rate cut.
- The FOMC also gave some forward guidance: 'The Committee expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals'
- The FOMC also started a new large scale asset purchase program, over the coming months the Committee will increase its holdings of Treasury securities by at least $500bn and its holding of agency MBS by at least $200bn.
- To support the flow of credit to households and businesses the Board of Governors extended the discount window to 90 days and slashed the primary credit rate by 150 bps. The Board has reduced the reserve requirement ratios to zero percent. The Board is encouraging depository institutions to utilize the intraday credit extended by Reserve Banks, and to use their capital and liquidity buffers as they lend to households and businesses who are affected by the coronavirus.
- The Board also enhanced the standing USD liquidity swap line arrangements with the Bank of Canada, the Bank of England, the Bank of Japan, the ECB and the Swiss National Bank by offering 84-day maturity, in addition to the 1-week maturity operations currently offered, and by reducing the pricing by 25 bps.
- The Fed is not done yet, as the FOMC statement repeated that the Committee will 'act as appropriate' to support the economy. This could take the form of strengthening forward guidance, increasing QE, increasing repo operations, further opening up the discount window and USD liquidity swap lines or introducing additional tools. For example, a range of liquidity tools from the financial crisis has not yet been put into action. This was a virtual 'alphabet soup', such as the Commercial Paper Funding Facility (CPFF), a more targeted liquidity tool, which was aimed at increasing the availability of credit for businesses and households.

Back to zero

Yesterday, the Fed made another emergency rate cut, this time by 100 bps. This brought down the target range for the federal funds rate back to 0.00-0.25%. This decision was not unanimous: Loretta Mester (Cleveland Fed) dissented because she preferred a reduction of the target range to 0.50-0.75%, which would have meant a 50 bps rate cut. The FOMC also gave some forward guidance: 'The Committee expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals.' In practice, we think the Fed will stay at the zero bound for at least the remainder of the year (see Table 1 at the end of this report.) In line with the target range hitting the zero bound, the Board of Governors cut the IOER and IORR rates to 0.10%.

Large scale asset purchases

The FOMC also started a new large scale asset purchase program: over the coming months the Committee will increase its holdings of Treasury securities by at least $500bn and its holding of agency MBS by at least $200bn. Last week, the New York already went from QE Light to [Stealth QE] when it expanded its bill purchase program across the range of maturities. So it was only a matter of time before the FOMC formalized this into a new asset purchase program, although Powell was still ambiguous about labelling it as QE at the press conference. While in the current environment it is mainly aimed at providing liquidity to the markets for Treasury securities and agency MBS, it will also reduce longer-term interest rates, supporting consumer spending, business investment and residential investment. So at least a large dose of Stealth QE.

Supporting the flow of credit

Meanwhile, the Federal Reserve Board (which is a subset of the FOMC) announced actions to support the flow of credit to households and businesses. The Fed extended the **discount window** to 90 days and slashed the primary credit rate by 150 bps to 0.25%. By providing liquidity to banks through the discount window the Fed tries to make sure that banks don't have to withdraw credit to their customers during times of market stress. In this way, the Fed could support the smooth flow of credit to households and businesses. The Board has reduced the **reserve requirement ratios** to zero percent. This means that banks no longer have reserve requirements, which should support lending to households and businesses. The Board also enhanced the standing **USD liquidity swap line arrangements** with the Bank of Canada, the Bank of England, the Bank of Japan, the ECB and the Swiss National Bank by offering 84-day maturity, in addition to the 1-week maturity operations currently offered, and by reducing the pricing by 25 bps to OIS+25bps. Finally, the Board is encouraging depository institutions to utilize the **intraday credit** extended by Reserve Banks, and to use their **capital and liquidity buffers** as they lend to households and businesses who are affected by the coronavirus.

What's next?

The Fed is not done yet, as the FOMC statement repeated that the Committee will 'act as appropriate' to support the economy. This could take the form of strengthening forward guidance, increasing QE, increasing repo operations, further opening up the discount window and USD liquidity swap lines or introducing additional tools. For example, a range of liquidity tools from the financial crisis has not yet been put into action. This was a virtual 'alphabet soup.' In our [FOMC Preview 'Crash to zero'] we highlighted for example the Commercial Paper Funding Facility (CPFF), a more targeted liquidity tool, which was aimed at increasing the availability of credit for businesses and households. In the meantime, stress in this market is increasing. Other facilities included the Money Market Investor Funding Facility (MMIFF) and the Primary Dealer Credit Facility (PDCF). Returning to the USD liquidity swap lines: these could be extended to wider set of central banks, longer maturities could be offered and pricing could be reduced further. And as we have argued before, the sooner the Fed introduces a standing repo facility the better. For now, the Fed will have to adjust its repo operations frequently.

The Fed will now have to focus on providing liquidity to keep financial markets functioning and to keep the flow of credit to households and businesses going. Meanwhile, it is up to governments, the health sector and ourselves to get the coronavirus under control.

At the press conference Powell also said that the emergency meeting on Sunday was in lieu of the scheduled meeting for March 17-18. This also means that we may have to wait longer for the new FOMC projections for the economy and rates. The next scheduled FOMC meeting is on April 28-29, but we may see another emergency meeting before then.

Our updated forecast of the Fed's path for the federal funds rate in 2020 is summarized in table 1. We expect the Fed to stay at the zero bound for at least the remainder of the year. At the press conference, Powell repeated that the FOMC does not think that negative rates will be an appropriate tool.

Table 1: Rabobank forecast of federal funds rate path

FOMC meeting	*Decision*	*Target range for the federal funds rate (%)*
29 Jan 2020		1.50-1.75
3 Mar 2020 (Emergency meeting)	50 bps cut	1.00-1.25
15 Mar 2020 (Emergency meeting)	100 bps cut	0.00-0.25
29 Apr 2020		0.00-0.25
10 June 2020		0.00-0.25
29 July 2020		0.00-0.25
16 Sept 2020		0.00-0.25
5 Nov 2020		0.00-0.25
16 Dec 2020		0.00-0.25

Source: Rabobank

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