

Central Bank Watch

Fed is now ready to cut more quickly and aggressively

After US and global stock markets suffered the worst week since 2008, Fed Chair Powell issued a surprise official statement reaffirming that the central bank would “act as appropriate” to respond to the risks posed by coronavirus. This rare inter-meeting statement hinted that Fed is ready to act preemptively soon to provide additional accommodation. We view that **a 50bp cut in March and a total of 50-75bp cut during 1H20** are now possible. At present, the market is overestimating Fed rate cut odds. The current non-financial public health concern is fast-moving so we need to closely monitor events right up until the meeting.

- **Fast-spreading virus is a game-changer for US Fed actions.** Fed was intending to keep rates steady at least for several months after cutting the benchmark lending rates three times last year to the range of 1.5-1.75%, until COVID-19 unexpectedly changed its policy pace. In the mounting concerns that the virus crisis would derail global economy (we have slashed growth forecast on 25 Feb), more than US\$7tr wiped off the value of stocks worldwide from the level of 19 Feb. Powell’s surprising formal brief statement on 28 Feb, as we interpret, made a clear stance that Fed is ready to take action very soon to counter the risks poses by virus spread and to soothe market fears.
- **We expect Fed to cut soon to soothe market. The timing and magnitude are the focus now.** We expect Fed to act soon this month, with an aggressive 50bp insurance cut, more likely on its 17-18 March meeting than an emergency gathering to authorize an inter-meeting rate cut, unless virus spread turns much worse rapidly. The yield curve has been inverting even steeper recently and a 25bp cut seems not enough to help normalize the shape of the yield curve. In addition to a March cut, we now see a sum of 50-75bp cut during 1H20 possible. The ultimate amount of easing depends on the economic fallout and outlook.
- **More signs of wider virus outbreak in US underway:** new cases have been increasing faster since 23 Feb in multiple US states. As of 3 Mar (8:00 GMT+8), 99 cases have confirmed in US. With testing ramping up this week, US may brace for more confirmed cases.
- **US economy remains solid and COVID-19 impact on it is expected to be fairly limited in 1Q20.** Powell said in his 27 Feb statement that “the fundamentals of the US economy remain strong, but COVID-19 poses evolving risks to economic activity”. Trump is counting on strong economy to win reelection this year, who said on 27 Feb that he hoped the Fed would step in soon and cut rates. Rate cuts, by making it cheaper to borrow money, would provide only a bit of supporting to the domestic demand, especially consumer spending; while virus risk hurts both supply and demand sides. If the infection numbers in US accelerate, stock prices would continue to feel pressure despite whatever Fed does.

US economy data summary

	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20
Unemployment rate	3.5	3.6	3.5	3.5	3.6
Change in payroll employment	208	185	261	147	225
Average hourly earnings	28.16	28.24	28.34	28.37	28.44
Consumer price index	0.1	0.2	0.2	0.2	0.1
Producer price index	-0.3	0.3	-0.1	0.2	0.5

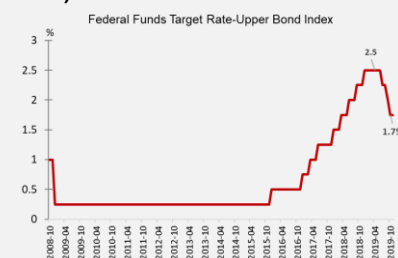
Source: US government, CMBIS (employment changes are in thousands; CPI and PPI are MoM change)

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US federal funds target rate (upper bond)



Source: Bloomberg, CMBIS

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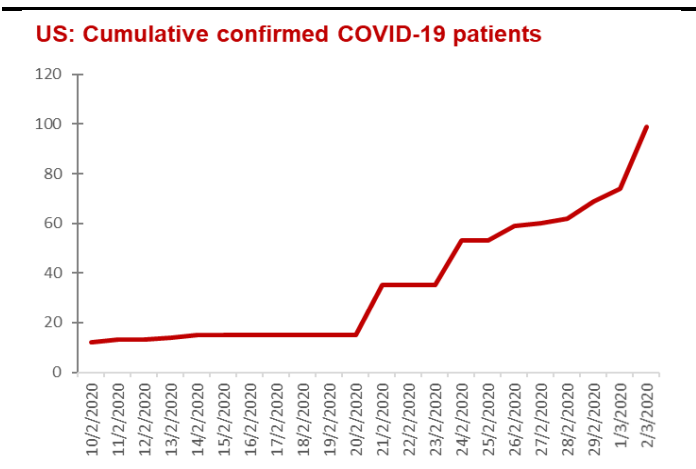
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Figure 1: Uncertainty remains as several Fed members were not ready to cut rates

Fed officials	Date	Comments on Fed actions
James Bullard (St Louis Fed President)	28 Feb	A rate cut is "a possibility" if the epidemic becomes a pandemic, but "that's not the baseline case."
Loretta J. Mester, (Cleveland Fed President)	27 Feb	Fed should keep its options open. "We always have to come in with open minds about what's going on with the economy, and every day we're getting new information, especially with something that's fast-moving, like this".
Richard Clarida (Fed Vice Chair)	25 Feb	"It is still too soon to even speculate" about the scale or persistence of the impact from the virus on the US economy.

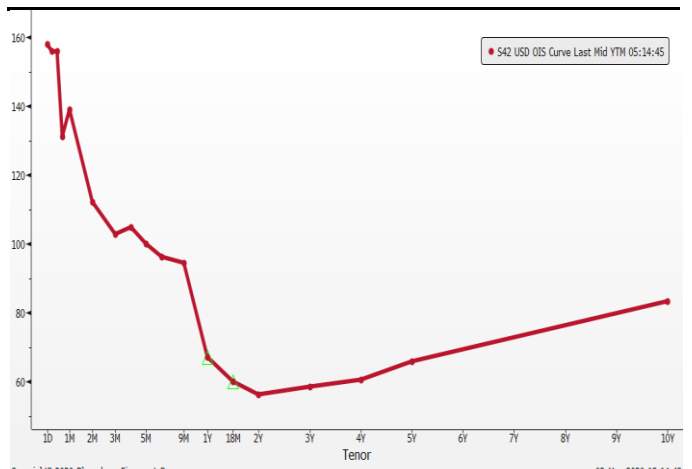
Source: Media reports, CMBIS

Figure 2: Growth of confirmed infection cases in US has accelerated since late Feb



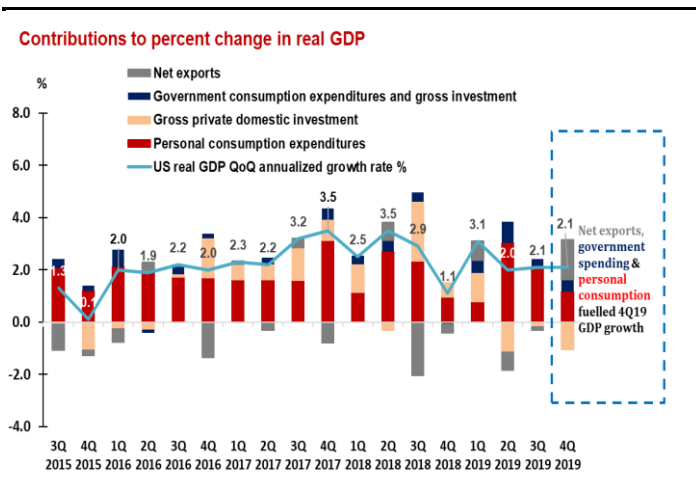
Source: US CDC, CMBIS (as of 3 Mar, 8:03 GMT+8)

Figure 3: The inverting US yield curve also pushes Fed to cut soon



Source: Bloomberg, CMBIS (as of 2 Mar, 10:00 GMT)

Figure 4: US economy expanded by a solid 2.1% in 4Q19



Source: US government, CMBIS

Figure 5: Fed fund futures signal more than 100bp rate cut this year



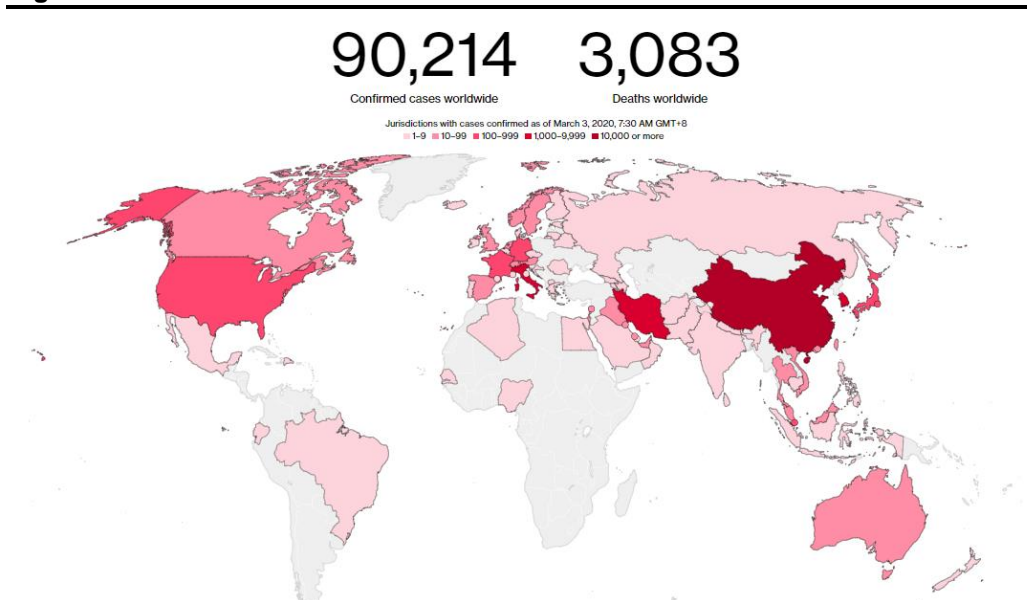
Source: Bloomberg, CMBIS (as of 2 Mar)

Figure 6: COVID-19 is affecting 76 countries and territories around the world and one international conveyance (the "Diamond Princess")

	Total cases	Total deaths	Total recovered
China Mainland	80,026	2,912	44,835
S. Korea	4,335	28	30
Italy	2,036	52	149
Iran	1,501	66	291
Diamond Princess	705	7	100
Japan	274	6	42
France	191	3	12
Germany	165		16
Spain	120		2
Singapore	108		78
Hong Kong, China	100	2	36
USA	99	6	9
Kuwait	56		
Bahrain	49		
Thailand	43	1	30
Taiwan	41	1	12
U.K.	40		8
Australia	33	1	15
Malaysia	29		22
Canada	27		7
Iraq	26		
Norway	25		
Switzerland	24		1
U.A.E.	21		5

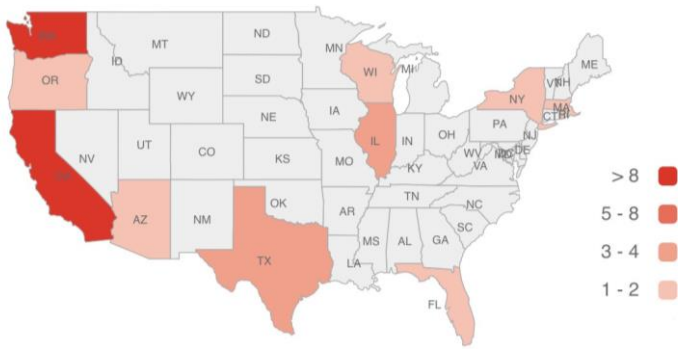
Source: WHO, Worldometers, CMBIS (only total cases above 20 are shown in the above table; as of 3 Mar, 8:03 GMT+8)

Figure 7: Coronavirus outbreak across the world



Source: Bloomberg, CMBIS (as of 3 Mar, 7:30 GMT+8)

Figure 8: Coronavirus outbreak in the USA



Source: US government, Worldometers, CMBIS (as of 3 Mar)

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