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WILL POLICY RESPONSE HELP TO CALM MARKETS?

Within three months of writing our annual market outlook, our sentiment on economic growth has shifted down. Within this time the global economy has suffered from both a deadly new virus spreading throughout the world and a steep decrease in the price oil. In January we stated, "*Entering 2020, it seems as if the Federal Reserve ("Fed") will hold steady with current policy. With over $18 trillion dollars in negative yielding debt internationally, it is likely we will see similar policy abroad. Moving forward, the Fed will want to see how things play out, as pulling interest rates too low could cause inflation to surge while pushing rates upwards could inadvertently induce a recession. We expect Fed Policy will remain unchanged throughout this year.*" A lot has changed since this piece was released.

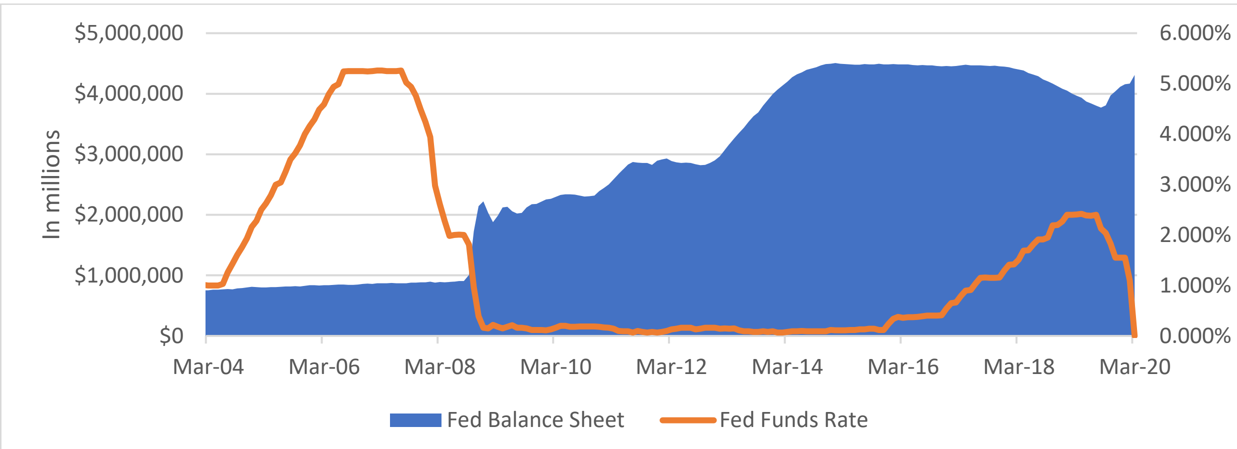
As of Sunday, March 15th we have witnessed the second cut by the Fed to bring rates to a range of 0.0 – 0.25%. Additionally, the Fed announced they will be engaging in $700 billion in asset purchases which will add an additional level of liquidity to the market. Lowering interest rates and engaging in asset purchases (Quantitative Easing) are two of the Feds main monetary policy tools. The FOMC statement on March 15th stated, *"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. This action will help support economic activity, strong labor market conditions, and inflation returning to the Committee's symmetric 2 percent objective."* With this it is likely we will see continuation of the *"lower for longer"* interest rate environment we have grown accustomed to the past decade.

To this point, the implementation of fiscal policy has been less extensive. Although there are promises out of the White House, we have yet to see much of a coordinated effort in the United States between the executive and legislative branches. As of today, the policy response has been primarily centered around funding for health care with over $8 billion going to testing, vaccine development and local health care departments. The aid package, which was signed on March 6th, is a good start, but is it enough? Rumors emerged out of the White House this morning that the administration was seeking $850 billion in additional stimulus to fight the effects of COVID-19. The package will now head to Congress for approval.

What Will Monetary Policy Accomplish?

It is likely that the additional monetary measures will have little near term effect. This is not a criticism of Fed actions as the goal was to boost business confidence and increase liquidity measures. Additionally, the market had priced in that the Fed would use the limited ammunition it had entering this period of volatility.

First, rates have been low for over 12 years which means there is not a lot of pent up activity that will benefit from a decrease in rates. This is not a cyclical downturn where monetary policy centers around increasing capital spending, home building and other cyclical sectors. This situation is an acute shock to the system that has disrupted supply chains and will have negative effects to the service sector, which is not as sensitive to interest rates as the manufacturing sector. At this point, decreasing rates from 1.25% to 0.0% is not going to get people out of their houses to shop, travel and dine. This situation leads to employees in the retail, hospitality, travel and dining space to be laid off or furloughed, resulting to a secondary shock to demand. This is where fiscal policy would come in to play.



Source: Federal Reserve

What Will Fiscal Policy Accomplish?

We have seen initial steps towards fiscal stimulus that would soften the blow to the U.S. and global economy. The stimulus would have both broad and targeted goals. An example of targeted goals would be to support the travel industry (airlines and cruise ships) who have been hit hardest by COVID-19. More broad goals would be to provide income and liquidity support to households and small businesses that could help them stay afloat during this period of stress. There are also conversations around halting student loan payments and removing payroll taxes for the time being.

These measures will have to be proposed by the executive branch and settled in the legislative branch, but it is reasonable to assume that all parties are hoping to get a plan initiated quickly in order to calm markets and provide support to the areas of the economy that need it most. It is clear that more needs to be done on a fiscal front, but the details of this plan could help to alleviate some of the stress that is being felt from a households, small businesses and multi-national corporations alike.

Prospectively, the cumulative impact of the current and proposed stimulus measures is likely to act as a material tailwind to economic activity once the health crisis has subsided

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