
DIGESTING THE FEDERAL RESERVE'S EMERGENCY RATE CUT

Wisdomtree EU
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If we reflect on history, the Federal Reserve (Fed) responded to an international stock sell-off by cutting the federal funds rate on 22 January 2008 to 3.5% from 4.25% initiating a 75 basis point emergency rate cut. Following that move, the Federal Open Market Committee had indicated the need for action was “in view of a weakening of the economic outlook and increasing downside risks to growth.” Fast forward to 3 March 2020 with the Fed initiating its first emergency rate cut since the 2008 crisis in the realm of 50 basis points. This time around the move is aimed at supporting an economy that is starting to see pressure from a supply side shutdown in parts of Asia and will soon expand more broadly.

The Fed rate cut could be a way for the Fed to try to reignite the demand side of the economic equation as Coronavirus fears are leading to less consumer spending in the middle of already slowing global growth backdrop. In China, car sales fell by 80% in February, leading to one of the largest monthly drops on record as consumer spending is impacted by measures aimed at containing the spread of the Coronavirus. This has put further pressure on the Chinese auto industry which was already in a two-year decline. On the supply side, Chinese factory activity was also one of the weakest on record with the manufacturing purchasing manager's index plunging to 35.7 in February from 50 in January 2020. While it is anticipated that many Chinese factories will restart to higher capacity levels by the end of March, we may begin to note greater impact elsewhere as the virus spreads to more countries. While the Fed's monetary easing may see some immediate impact on the housing market, we may not notice the desired impact on the demand side of the equation without a commitment to fiscal stimulus.

As the contagion of the Coronavirus has begun to expand across Europe, the European Central Bank has less monetary tools at their disposal to try to reignite consumer demand. While we have yet to see strong fiscal stimulus commitment from Europe, this could be the event that tips countries with strong budgets to shift towards fiscal expansion. The appropriate measure of fiscal expansion may be the tool that helps give a boost to the demand side of the equation and help support weakening growth in the first half of 2020.

Unless otherwise stated, data source is Bloomberg, as of 04 March 2020.

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