



Is the US Fed Monetary Policy the only game in town?

Post-G7 finance ministers and central bankers' tele-conference on Tuesday (3 March), the US Federal Reserve (Fed) Chairman Jerome Powell "walked the talk" of using all appropriate policy tools and announced a 50bps emergency Fed rate cut to bring the Fed Funds Target rate (FFTR) range to 1.00-1.25%.

The surprise and unanimous Fed decision ahead of the FOMC meeting on 17 March was meant to address the uncertainty surrounding the coronavirus outbreak (COVID-19) and the Fed judged the outbreak will weigh on the economy for some time but the economic impact remains uncertain. It is also unclear how long the outbreak will last, even though Chairman Powell still expects US to return to solid growth. However, the markets were not calmed by the move and sold off sharply during and after the announcement. Major indexes suffered losses in excess of 2% and the benchmark 10-year Treasury note yield fell below 1% for the first time ever. Markets appear to have been concerned by the sense of panic from the Fed, and the fact that there does not appear to be any other policy tools that are expected to be used other than rate cuts. There also appears to be some disappointment that only the Fed acted after the G7 call.

Following the surprise move, we now expect the Fed to implement another 50bps rate cut in the March FOMC, to bring the FFTR range down to 0.50-0.75% for the remainder of 2020, as another insurance cut in view of the rising risks to the US outlook from the COVID-19 outbreak. Note that there is a non-negligible risk that the Fed could slash by an even bigger 75bps. While we have not priced in further rate cuts beyond 1Q, the Fed still has room for at least one or two more 25 rate cuts if the risk factors escalate and more accommodation is needed to safe-guard the economy. That said, we do not think the Fed will want to push rates beyond zero, into negative territory.

The contours of COVID-19 impact on the US and Europe are starting to resemble the anxiety levels Singapore and parts of Asia had witnessed at the beginning of February. While Singapore and rest of the region are arguably resuming some normalcy, it remains to be seen if US and Europe would follow suit in the coming months. The question from here is what further adjustments the Fed will make if the COVID-19 damage is not contained with the data; markets (including US President Trump), indeed, will likely demand more action. While it is a common complaint that the Fed rate cuts are "pushing on a string", the general consensus is that in this event, the Fed rate cuts may be limited in their purpose and extent of effectiveness. It will take a lot more than Fed rate cuts to help encourage people to travel, or to help companies increase production when factories are shut. And it certainly won't stop anyone from falling ill. The consensus view is that fiscal policy measures may be more effective but there are no signs to do so from policymakers other than China.

Our house view

We are neutral equities, commodities and fund a slight overweight in fixed income by underweighting cash. In fixed income, we are short in duration, at least until the zero bound in US interest rates is reached. We favour Developed Markets over Emerging Markets debt and we are overweight Investment Grade and underweight High Yield.

Our overall asset allocation is in line with our view of the COVID-19 outbreak as a deflationary shock. The economic and earnings effects are likely to be transient and thus allow equities to recover losses. But the deflationary impact is

likely to be longer-lasting implying global monetary policy easing and a more lasting effect on suppressing global bond yields. We now expect 2 more US Fed rate cuts in 2020.

Our base case is that economic growth will rebound to normal in 2H20 and equity markets will fully recover losses after the number of cases start to decline convincingly. Bond yields may have overshoot on the downside in the short term, but most of the bond rally is likely to be sustained.

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