Is it 'material'?

The Fed must decide, on its own, if the coronavirus outbreak qualifies as such.

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Early February seems like years ago. As December and January data flowed in with positive reports on manufacturing, housing, employment and retail sales, the Federal Reserve looked pretty smart saying it would refrain from policy moves unless there were "material" changes to the economy.

Well, the coronavirus may very well qualify as one. When the outbreak reached Europe this week, it hit close to home. You don't have to have your eyes glued to a screen to know this outbreak will be with us for a while and that it will have some economic impact. But will it be material and, in turn, how should the Fed react?

Earlier this week, Fed Vice Chair Richard Clarida acknowledged the virus likely would disrupt the global economy but it was too soon to speculate about how large that might be and how long it would last. Investors seemingly have made

up their minds that it will be significant and expect a rate cut at April's Federal Open Market Committee meeting.

But there is, of course, the little matter of the FOMC meeting in two weeks. We think the Fed should not lower the fed fund rate then. The Fed likely is viewing the virus like a natural disaster: it wants to get ahead of it, but not make things worse. The markets seem to want the Fed to fear the future as much as they do. Policymakers must make clear they make their own decisions—that they indeed operate independently. And this stance needs to be true. Just like the market shouldn't fight the Fed, the Fed can't be led by it. Its job is to forge monetary policy consistent with the broadest point of view.

It is debatable just how effective a cut would be at this point, and policymakers know that. There certainly is no lack of liquidity in the marketplace. In fact, the situation might stoke higher inflation as that is often a byproduct of a supply chain disruption. Anytime you introduce inefficiencies into the marketplace, there is potential for prices to rise. The Fed might be looking for higher prices, but a cut could allow for too much. More than likely is that things will return to the abnormal normal state of low inflation once the virus abates.

What the Fed needs to do now is to talk the market in the right direction. Former chairs Bernanke and Yellen were fluent in Fedspeak. It's not that Powell isn't, but it has been more of a challenge with the current Fed because it has dissention in the ranks. You have Rosengren talking one way in Boston, Fisher at Dallas talking a completely different way and then Kashkari with a different take in Minneapolis. Time for some solidarity.

As a firm, we are making "maintenance trades" to keep us within our weighted average maturity (WAM) ranges of 35-45 days for government funds and 40-50 days for prime and tax-free ones. This has not been easy because of the lack of good relative value with the London interbank offered rate (Libor) and the

Treasury curves' flattening, although Sifma rates have been attractive. So we have cast our net wide, buying securities, both fixed and floating, all across the short-end of the curve without any real conviction that one area is better than another. We are positioned for further lowering of yields but also prepared for a rise when the clouds break.

TAGS

LIQUIDITY | MONETARY POLICY | MARKETS/ECONOMY

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Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

London interbank offered rate (Libor): The rate at which banks can borrow funds from other banks in the London interbank market. The Libor is fixed on a daily basis by the British Bankers' Association and acts as a benchmark for other short-term interest rates.

The Securities Industry and Financial Markets Association Municipal Swap Index (Sifma) is a 7-day high-grade market index comprised of tax-exempt Variable Rate Demand Obligations (VRDOs) with certain characteristics.

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