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Market View – What comes after an emergency cut?

By Taylor Schleich

Today's emergency interest rate cut by the Federal Reserve certainly caught markets off guard. And while it had been nearly twelve years since the Fed had cut its policy rate in between its regularly scheduled meeting dates, we do have a semi-decent sample size looking back at the past quarter century. Between 1998 and 2008, the Fed had intervened seven times inter-meeting to loosen monetary policy, while the Bank of Canada usually wasn't far behind, often stepping in to provide emergency relief in near-immediate proximity to the Fed cut. Here is a look at the empirical record:

- **October 1998:** In response to growing caution by lenders and unsettled conditions in financial markets, the Fed cut rates by 25 bps between its scheduled September and November meetings in 1998. The Bank of Canada, who hadn't yet transitioned to fixed meeting dates, responded the next day with a cut of its own. At the subsequent meetings, both central banks again reduced its policy rates by 25 bps.
- **January 2001:** High energy prices, weak production and low consumer confidence prompted the Fed to deliver 50 bps of relief in early January, four weeks before its next meeting. While the BoC didn't immediately take action, they did reduce overnight by 50 bps when the next meeting date rolled around three weeks later. At its next scheduled meeting at the end of January, the Fed delivered another 50 bps.
- **April 2001:** A weak business outlook and significant equity market declines forced the Fed to inject 50 bps of stimulus four weeks before its next meeting. Though the BoC didn't follow suit, this is because they had already cut by 25 bps on the prior day. At each of the central banks' next meetings, target rates were lowered further—by 50 bps in the US and by 25 bps in Canada.
- **September 2001:** In response to 9/11, both the Fed and BoC provided 50 bps of easing between meetings on September 17. The Fed cut further at its next meeting two weeks later, bringing the fed funds target down another 50 bps. The BoC, meanwhile, cut 75 bps five weeks later at its next regularly scheduled meeting date.
- **August 2007:** While the Fed didn't change the target for fed funds, it did lower its discount rate as the subprime-mortgage market continued to deteriorate, before the global financial crisis had yet to fully get in gear. However, the Fed did follow this inter-meeting action up a month later with a 50 bp cut to its policy target. This is the only instance in our sample where the BoC didn't either cut on the same day or at its next scheduled meeting.
- **January 2008:** With housing markets contracting, financial markets deteriorating and labour markets softening, the Fed cut its policy rate by 75 bps. The BoC, which happened to have a scheduled meeting the same day, delivered 25 bps of easing. At each of the central bank's following scheduled meetings, 50 bps of further accommodation were provided (eight days later from the Fed and six weeks from the BoC).
- **October 2008:** In what was a globally coordinated move, when the stability of the financial system appeared to be at stake, the Fed joined the ECB, BoE, Swiss National Bank, Riksbank and the BoC in providing emergency monetary accommodation. Both the Fed and BoC cut their policy rates by 50 bps. The BoC followed that up 13 days later with another 25 bps and the Fed doubled down with 50 bps at its next scheduled meeting three weeks later.

Bottom Line: If there's one thing that we can observe from emergency, inter-meeting Fed cuts of years past, it's that when one occurs it's never a one-off. Furthermore, very little time goes by (on average, just 23 days) before the Fed cuts rates again and often by multiple "notches" (50 bp cuts occurred six of seven times in the sample). While we're not ready to call for another 50 bps from the Fed in just 15 days' time, we do think the probability of the Fed delivering further stimulus is high, as the empirical record demonstrates. (Of course, this will too depend on how financial conditions progress and the evolution of data, both economic and epidemiological.) And when it comes to the Bank of Canada, it's clear that when the Fed is forced to step in outside of its regularly scheduled meeting calendar, they aren't usually far behind. Indeed, the only time BoC easing didn't follow Fed easing was when Bernanke and company cut only the discount rate. And while the magnitude of easing by the BoC has been less in this sample set, when central bank action has been coordinated (see October 2008, September 2011), the amount of stimulus is typically the same. It's why we now see a 50 bp reduction to overnight being delivered Wednesday morning.

Table: Emergency Fed rate cuts and subsequent meetings/BoC reaction

Emergency interest rate cuts by the Federal Reserve and interest rate changes at the next regularly scheduled policy meeting

	Emergency Fed Cut Date	Fed Action	Rate before action	Rate after action	Change (bps)	Next meeting date	Days to next meeting	Rate after next meeting	Change (bps)	BoC cut by next meeting?
	15-Oct-98	Cut	5.25	5.00	-25	17-Nov-98	33	4.75	-25	Yes
2001 recession	03-Jan-01	Cut	6.50	6.00	-50	31-Jan-01	28	5.50	-50	Yes
	18-Apr-01	Cut	5.00	4.50	-50	15-May-01	27	4.00	-50	Yes
	17-Sep-01	Cut	3.50	3.00	-50	02-Oct-01	15	2.50	-50	Yes
Financial crisis	17-Aug-07	Cut discount rate*	5.25	5.25	0	18-Sep-07	32	4.75	-50	No
	22-Jan-08	Cut	4.25	3.50	-75	30-Jan-08	8	3.00	-50	Yes
	08-Oct-08	Cut	2.00	1.50	-50	29-Oct-08	21	1.00	-50	Yes
	03-Mar-20	Cut	1.75	1.25	-50	18-Mar-20	15	?	?	?

Source: NBF, Bloomberg, Federal Reserve, BoC | *The discount rate, the rate the Fed charges qualified lenders, was cut by 50 bps in response to the subprime mortgage crisis.

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