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As stock markets tumble because of coronavirus, this time feels different

Traditional methods for arresting an investor panic might be no match for fallout from a global pandemic

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The stock market fell for the seventh straight day Friday, with the Dow Jones industrial average losing 357 points, or 1.4 percent, to close at 25,409. Only by staging a late rally in the final 15 minutes of trading was the Dow able to avert its third daily loss this week of more than 1,000 points.

The sustained sell-off, driven by fears of global economic damage from the spreading coronavirus, prompted both the Federal Reserve and the White House to hunt for possible remedies, eyeing tools they have used during past crises to calm the public.

The traditional tactics, however, may not work against a financial panic driven by a global health scare that lacks precedent or antidote.

A sign of the crisis-fighting difficulties ahead came in the afternoon, when Federal Reserve Chair Jerome H. Powell issued an unusual statement vowing to "act as appropriate" to defend the U.S. economy from the outbreak. Many analysts interpreted the statement as a pledge to cut interest rates, a signal that often heartens investors. But this time, the sell-off continued.

Markets plunge again Friday, as concerns about coronavirus continue

After a week that shaved more than $4 trillion from global stock values, Powell's effort was among a series of steps meant to reassure frazzled investors. Nothing, so far, appears to be working.

"The fundamentals of the U.S. economy remain strong," Powell said. "However, the coronavirus poses evolving risks to economic activity. The Federal Reserve is closely monitoring developments and their implications for the economic outlook. We will use our tools and act as appropriate to support the economy."

Evercore ISI, an investment firm, told clients Friday that it now expects the Fed to cut rates by a half-percentage point at its mid-March meeting, something few expected just one week ago.

Meanwhile, White House officials held meetings of their own Friday, considering potential tax-cut packages that they hope might boost consumer confidence. This comes after several days of unsuccessful efforts by President Trump and his economic team to cajole people to buy stocks and drive prices higher.

The Fed and White House deliberations illustrate how policymakers are searching for ways to arrest the sudden sell-off, which some analysts say raises the possibility of a recession later this year.

Typically, the Fed responds to economic trouble by lowering interest rates to make credit easier to obtain. It also can offer loans to banks or buy large quantities of U.S. Treasury securities, effectively adding money to the financial system and making it easier for some corporate borrowers to get cash to. The White House and Congress, meanwhile, can approve new spending or tax cuts to flood the economy with money.

But the best remedy for the coronavirus — which has sickened more than 83,000 people worldwide and killed nearly 3,000 — could lie beyond Washington's immediate powers.

"Central banks don't make vaccines," said David Kotok, chairman of Cumberland Advisors.

The renewed selling intensified calls for the Fed to rescue the economy from an unforeseen shock. The medical emergency already has disrupted global production networks, curtailed air travel and hobbled economies in Asia, Europe and the Middle East. With medical experts urging Americans to prepare for serious disruptions in their daily lives, pleas for early action are coming from Wall Street and some former members of the Fed's rate-setting committee.

"The Fed can't fix broken supply chains or calm concerns about health and safety. But the Fed can ensure that liquidity conditions remain supportive, so firms can get funding through the disruption. It can also provide support to financial markets," said Nathan Sheets, chief economist for PGIM Fixed Income. "More generally, the message that the Fed is attentive and 'on the case' has tended to help soothe the economy and the markets during past episodes."

By Friday, surveys of investors showed there was a nearly unanimous belief that the Fed would cut rates by at least a quarter-percentage-point at its March 17-18 meeting. That represents a sharp and sudden change from one week ago, when just 11 percent expected Fed action, according to the CME Group.

The shift comes as Capital Economics told clients that the continued spread of the disease in the United States, which has seen roughly 60 cases so far, "could be enough to tip the economy into a mild recession."

It's uncertain, though, how effective cutting interest rates might be. Economists call an episode like the epidemic or the Sept. 11, 2001, terrorist attacks an "exogenous shock," meaning an unpredictable development that arises from outside the economy or financial system yet has significant economic consequences.

The Fed normally acts only after assessing voluminous data on business and consumer activity, using sophisticated computer models that forecast the future by comparing current conditions to what's happened in the past. There is no recent precedent for the coronavirus outbreak for the Fed to use in its models.

Recessions can occur after the Fed has begun raising interest rates to head off incipient inflation, or after warning signs such as widespread layoffs or falling equipment orders. As the economy gradually deteriorates, the Fed can cut rates to encourage more spending. The White House and lawmakers, meanwhile, often support more spending or tax cuts to boost the economy.

Jerome H. Powell, chairman of the Federal Reserve, called on Congress to get ready to help in the event of a future recession. (Andrew Harrer/Bloomberg News)

The coronavirus, which first emerged in China and has now spread to countries including South Korea, Japan, Italy, Iran, Brazil and the United States, poses a unique challenge. In this case, the virus materialized with no warning and, after initially appearing to be confined to China, swept into roughly 60 countries.

Trump, who has been criticized for a delayed and uncertain response to the crisis, so far has given no hint of plans for any economic stimulus, but his aides are looking at a range of options.

China stands as a cautionary tale. The Chinese government's aggressive measures to fight the crisis, including imposing quarantines over an area that is home to perhaps 60 million people, chilled both supply and demand.

China's virus-fighting campaign prevented employees from leaving their homes and working on assembly lines, thus depressing the supply of goods. And it kept people from patronizing restaurants, movies or retail stores, thereby cutting demand.

If the United States suffers a serious outbreak and people stay home, fearing possible contagion, cutting interest rates would probably do little to persuade them to return to work or go out to shop or dine. "This is a very tough one for the Fed to deal with," said Dean Baker, senior economist at the Center for Economic and Policy Research.

The Fed has a long history of fighting financial and economic downturns, including the 1987 stock market plunge known as Black Monday and the Russian debt default more than a decade later. In 2008, after the collapse of the housing bubble, the Fed dropped interest rates to zero and held them there for years in a bid to resuscitate the U.S. economy.

The Fed moved quickly in the wake of 9/11 to try to limit the economic fallout. Six days later, with financial markets closed and smoke still curling from the World Trade Center rubble, then-Fed Chairman Alan Greenspan cut the benchmark U.S. lending rate by half a percentage point. The central bank also pumped $102 billion into the financial system to grease the gears of the economy and ease an anticipated slowdown, according to a subsequent study by the Federal Reserve Bank of St. Louis.

Until Friday, Fed officials had been cautious in their public comments. Richard Clarida, the Fed's vice chairman, said earlier this week that the upheaval in China could reverberate through the global economy. "But it is still too soon to even speculate about either the size or the persistence of these effects, or whether they will lead to a material change in the outlook," he said in a speech to an economists conference in Washington.

For the past three years, the Fed has helped investors shrug off Trump's serial trade wars, cutting interest rates three times last year as inflation remained low.

Between Election Day in 2016 and Feb. 12 of this year, the Dow Jones industrial average rose by 61 percent. In four days this week, it surrendered one-third of that gain as investors puzzled over what the virus will mean for corporate earnings.

By itself, this week's historic stock market meltdown — erasing nearly two years' worth of gains and incurring the fastest 10-plus-percent drop in history — highlights the current peril.

Economists are struggling to assess the extent of the calamity amid conflicting information about the virulence of the illness, the likely public reaction if it spreads in the United States, and the potential response from the Fed or the Trump administration. To some, the profound uncertainty recalls the financial crash that hit the United States and Europe more than a decade ago.

"Forecasting in this environment feels eerily reminiscent of the crises — the ground keeps shifting beneath me as I try to gain my footing," Diane Swonk, chief economist at Grant Thornton, tweeted Thursday.

The cloudy outlook shows no signs of clearing anytime soon. On Friday, Fitch Solutions, a risk analysis firm, said it was revising down its forecasts for several European economies, including Germany, after already having lowered its Asian estimates.

One day earlier, Fitch said South Korea would grow by just 1.7 percent this year, down from its 2.2 percent original forecast. And that estimate could go lower, the firm said, citing the risk that "the outbreak will not be controlled by June."