



Fed aggressively cuts rates

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WASHINGTON (AP) -- The Federal Reserve slashed a key interest rate by three-quarters of a point Tuesday, capping its most aggressive two months of action in a quarter-century in a battle to halt a spreading credit crisis. Wall Street loved it, bursting to its biggest gain in five years.

The strong Fed action seemed to convince investors, at least for now, that the central bank will do whatever it can to keep the country out of a steep recession. The Dow Jones industrial average finished the day up 420.41 points at 12,392.66.

The latest Fed move brought the federal funds rate -- the interest that banks charge each other -- down to 2.25 percent, the lowest since late 2004.

That's important far beyond bank boardrooms. The reduction triggered announcements from commercial banks that they were cutting their prime lending rate to 5.25 percent from 6 percent. This rate is the benchmark for millions of business and consumer loans.

Local bankers said the rate cut is significant and should provide a boost to both businesses and homeowners in northern Michigan weathering an on-going credit crunch and housing slump.

"I think the expectation was between 50 and 100 basis points, but 75 is a very stimulative reduction," said Eric Shaffer, market president for National City bank in Traverse City. "I think the effect on businesses and homeowners will be positive."

Shaffer said the Fed's rate cut should help homeowners faced with mortgage rate adjustments in the coming months.

"You're going to see mortgage re-sets that hopefully will continue to decline to a lower rate than they are today," Shaffer said.

John Paul, executive vice president and director for the Bank of Northern Michigan, said the recent economy has been tough on area residents living on fixed incomes or limited retirement savings, particularly when coupled with high gasoline and energy costs.

But the rate cut is welcome news to small and mid-sized businesses looking to expand, he said, and could help revive the region's housing market through lower interest rates for prospective home buyers.

"I do think the moves that have been taken have come at a very important time for this economy," Paul said.

The Fed action was designed to lower borrowing costs and boost spending by consumers and businesses and thus increase economic activity. Economic growth slowed to a near standstill in the final three months of last year as the nation was hit by a series of blows including the credit crunch, a prolonged housing slump, rising unemployment and surging energy prices.

The Federal Reserve has now cut its rate by three-fourths of a percentage point twice this year. The first occurred at an emergency meeting on Jan. 22 and was followed by a half-point cut at a regular meeting on Jan. 30. The three rate cuts over the course of two months represent the most aggressive Fed credit easing since mid-1982 when the Paul Volcker-led Fed was working to get the country out of a deep recession.

Fed Chairman Ben Bernanke and his colleagues have now cut the funds rate six times since last September, with the reductions becoming more aggressive since January as the central bank has faced growing turmoil in global financial markets.

The Fed also announced Tuesday that it was reducing its discount rate for banks by a similar three-quarters of a point, pushing it down to 2.5 percent. That cut, which followed a quarter-point reduction on Sunday, was seen as a clear signal that the Fed is ready to supply significant amounts of credit in direct loans to banks and other institutions through its discount window in an effort to stabilize financial markets roiled by the collapse over the weekend of Bear Stearns, the nation's fifth largest investment bank.

"We had been on the brink of the biggest financial meltdown this country had ever seen, but I think the Fed has now turned the psychology around," said David Jones, chief economist at DMJ Advisors. "The Fed is saying it is ready to supply all the emergency credit banks need to get us out of this crisis."

Many analysts said they believed the Fed may cut rates only once more, perhaps by a more ordinary quarter-point at the next meeting, and then sit back and see if economic stimulus checks that will begin arriving at 130 million households in May will do the trick along with the rate cuts to jump-start the economy.

There was opposition to Tuesday's decision, which was approved on an 8-2 vote. Richard Fisher, president of the Dallas Fed regional bank, and Charles Plosser, president of the Philadelphia regional bank, both dissented, preferring less aggressive moves. It marked the first time there have been as many as two dissents since the fall of 2002.

However, there has been no apparent change in the stance of Bernanke and the majority of Fed members that at the moment the greatest threat to the economy is from a possible recession, which may have already started, rather than from inflation that might be kindled by low rates.

"The Fed's statement signaled that the risks still are very much on the downside and they are willing to do whatever is necessary to make sure the economy doesn't slide away," said Mark Zandi, chief economist at Moody's Economy.com.

In explaining its actions, the Fed said that it was having to navigate a difficult policy environment that included sluggish economic activity and rising inflation pressures. It said anew that it was prepared to take further actions.

"Financial markets remain under considerable stress and the tightening of credit conditions and the deepening of the housing contraction are likely to weigh on economic growth over the next few quarters," the Fed said in its statement.

In Jacksonville, Fla., Tuesday, President Bush said the government will take further action -- if necessary -- to help the sagging economy.

The spectacular fall of Bear Stearns has raised concerns about what other banks might fail as a result of multibillion-dollar losses that began last year with rising defaults on subprime mortgages, loans made to borrowers with weak credit histories. However, two investment banks, Lehman Brothers Inc. and Goldman Sachs Group Inc. reported better than expected first quarter results on Tuesday, easing market worries.

Stocks had already been up strongly Tuesday before the Fed action. After the interest-rate cut was announced, stock prices slid lower as investors digested the fine print, then the buying resumed in earnest.

The purchase of Bear Stearns by JPMorgan Chase & Co. was helped by a pledge from the Fed that it would supply a \$30 billion line of credit to back up Bear Stearns' assets.

That offer was the latest in a number of unconventional moves the central bank has made, including employing Depression-era procedures to pump cash into the financial system.

In addition to providing support for the Bear Stearns sale, the Fed also announced Sunday one of the broadest expansions of its lending authority since the 1930s, saying it would allow securities dealers for at least the next six months to borrow directly from the Fed. That privilege had been confined to commercial banks.

In other moves, the Fed last week announced that it would lend up to \$200 billion of Treasury securities that it owns to investment banks starting March 27 for a period of up to 28 days in return for a like amount of the investment banks' shunned mortgage-backed securities. The Fed also announced recently that it was boosting the size of special loans it has been making since December to commercial banks.