



Gary Webb
RFC® & CEO

In the Press:



Interest Rates Slashed to Help Economy

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Fed's dramatic action lowers target on key short-term rate for the first time in 4 years - to 4.75% - and signals more cuts could be coming.

The Federal Reserve cut the target on a key short-term interest rate by half of a percentage point Tuesday to 4.75% in a bold acknowledgement that the central bank is concerned the mortgage meltdown plaguing Wall Street and Main Street could hurt the economy.

The Fed also indicated that more rate cuts could be on the way, news that investors cheered.

Stocks surged following the announcement, with the Dow finishing the day up more than 330 points, or 2.5 percent. The Nasdaq shot up 2.7 percent while the S&P 500 closed nearly 3 percent higher. Bonds fell, sending the yield on the benchmark 10-year U.S. Treasury up to 4.5 percent. (Bond prices and yields move in opposite directions.)

"This took some investors by surprise. It's like the Christmas present you really wanted but weren't really expecting," said Gary Webb, chief executive officer of Webb Financial Group, a Bloomington, Minn.-based independent investment advisory firm with about \$120 million in assets under management.

The cut to the federal funds rate, the first since June 2003, was widely anticipated by investors and followed a surprise cut to the Fed's discount rate on Aug. 17. The only question was whether the Fed would lower the federal funds rate by 25 basis points or 50

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basis points. (There are 100 basis points in a full percentage point.)

On Tuesday, the Fed also cut its discount rate by another half of a point to 5.25 percent. The central bank said that the vote to lower both rates was unanimous.

Some investors had thought that Fed chair Ben Bernanke would take a more cautious approach and not cut rates by such a large margin, because a half-point cut could signal the Fed was acting out of desperation to save the economy.

[Read the Fed statement](#)

But Alan Skrainka, chief market strategist with Edward Jones in St. Louis, disagreed with that

interpretation. He said Wall Street was cheering the rate cut because it proves the Fed is willing to take any moves necessary to ensure the economy is not derailed by problems in the subprime mortgage market, loans made to consumers with less-than-perfect credit.

"We're having champagne and cookies," Skrainka said. "This is not a magical elixir that solves our subprime problems overnight, but it is a big step in the right direction to keep the economy growing. The Fed is sending a strong message that it won't get behind the curve," he added.

The federal funds rate, an overnight lending rate that banks charge each other, is important since it influences the amount of interest consumers must pay for various types of debt, such as credit cards, home equity lines of credit and auto loans. The rate cut should help some beleaguered home borrowers who are set to see monthly payments on adjustable rate mortgages rise later this year.

In its statement, the Fed said that "the tightening of credit conditions has the potential to intensify the housing correction and to restrain

economic growth more generally" and that the rate cut "is intended to help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets and to promote moderate growth over time."

Chris Probyn, chief economist with State Street Global Advisors in Boston, said that with oil prices rising, consumer confidence sinking and the job market starting to show signs of weakness, the Fed made the right move to reassure investors.

Stocks surge on rate cut

"It was virtually a no-brainer to cut rates. Why risk destabilizing already fragile markets? This was an entirely appropriate response," Probyn said.

Webb of Webb Financial added that Tuesday's decision to cut the discount rate, which is what banks pay to borrow directly from the Federal Reserve, for the second time in a month is a sign that the Fed needed to do more to stimulate lending activity by nervous banks.

"The main reason the Fed had to cut both rates was the mortgage situation. That's going to keep getting worse but this should lessen the blow and make the market recover sooner," Webb said. "It will make cash more available for consumers and banks, good or bad. People that need money will go out and get it."

And Probyn said the Fed, if anything, should have cut the discount rate even further so that it would be in line with the federal funds rate.

Although investors applauded the rate cut, another market expert cautioned that this does not mean an end to the credit crunch.

"People should not assume that the economy's problems are over. That would be a mistake. They are significant and they are widespread," said Larry Smith, chief investment officer with Third Wave Global Investors, a Greenwich, Conn.-based investment advisor with about \$400 million in assets. "Today's action, while important, does not put to rest the fears that emanate from the credit concerns."

August foreclosures zoom

But Smith said the rate cut was a "bold step" and that he expected the Fed to cut interest rates at least one more time, probably by just a quarter of a percentage point though, before the end of the year.

The Fed's next monetary policy decision is scheduled to take place at the end of a two-day meeting on Oct. 31 and its last meeting of the year is set for Dec. 11.

Another market watcher agreed that the Fed has room to cut rates further and dismissed concerns that more rate cuts would create another easy-money environment of the type that got borrowers and banks in trouble in the first place.

"Rates are nowhere near the 1 percent historic lows they were at in 2003 and 2004," said Robbert Van Batenburg, head of research with Louis Capital Markets, a broker dealer based in New York. "The Fed has the luxury of leaving the window open for

more rate cuts."

To that end, according to federal funds futures on the Chicago Board of Trade, investors are now pricing in a 100 percent chance that the Fed will cut rates at least one more time before year's end.

And Skrainka of Edward Jones said he expects the Fed to cut rates several more times during the next few months.

"This is the beginning of an easing cycle. This is not one-and-done move by the Fed," he said.

But one economist said it is not guaranteed that the Fed will cut rates again in October.

Tom Higgins, chief economist with Payden & Rygel, an institutional investment firm based in Los Angeles with more than \$50 billion in assets under management, said he thinks the Fed is trying to "snap the market out of its funk" with a big rate cut now so it won't have to cut rates any further. With that in mind, Higgins thinks the Fed might hold pat in October.

But ultimately, Higgins said the Fed will have no choice but to cut rates again later this year. Today's reduction, he said, will not be enough to get the economy quickly back on track since rate cuts typically take several months to have a broad impact.

"I think the Fed is hoping it won't have to cut rates more but I doubt it will be successful. The economic data is likely to come in on the softer side over the next few months and they will have to move again," Higgins said.