

# Fed moves the market

## Stocks rebound after key interest rate is cut, easing credit

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Financial markets snapped out of their funk Friday, staging a strong rally after the Federal Reserve cut a key interest rate in an effort to ensure that credit, the life blood of global business, continues to flow.

In an unusual step taken just before markets opened, the Fed announced it was cutting the discount rate it charges banks for loans from 6.25% to 5.75%.

The action was symbolic and intended to let the market know that the Fed was paying attention to deteriorating credit conditions, said Jon C. Bruss, chief executive officer of Fortress Partners Capital Management Ltd., Hartland, which specializes in bank stocks.

For the past month, problems with repayment of mortgage loans made to persons with poor credit histories have riled capital markets worldwide, causing some banks to cut back on all kinds of lending. Concerns that credit was becoming difficult or impossible for some to obtain has been reflected in stock markets. On Thursday, the Dow Jones industrial average fell to 10% below its all-time high of 14,000, posted last month, before rebounding in the final hour of trading.

The rally was sustained Friday after the Fed's action was announced, with the Dow gaining 233 points, or 1.8%, to close at 13,079. The broader Standard & Poor's 500 index was up 35 points, or 2.5%, to 1446.

Whether the momentum will continue on Monday is an open question.

"When you get a strong move like today, I think there is going to be a little bit of digestion," said Ignatius Smetek, president of Arcataur Capital Management LLC in Milwaukee.

For the week, the Dow ended down 160.46, or 1.21%, at 13,079.08. The Standard & Poor's 500 finished down 7.70, or 0.53%, at 1445.94. The Nasdaq composite ended down 39.86, or 1.57%, at 2505.03.

## Other possible steps

There are additional steps the Fed can take if the markets continue to falter.

Friday's action came after the Fed already had pumped about \$17 billion into capital markets in recent weeks in an effort to make sure banks had money to lend.

Few observers expected it to follow that up by cutting the discount rate. The move was even more unusual because it came between regularly scheduled meetings of the Fed's Open Market Committee, which makes such decisions. The committee took the action at a special, unannounced gathering Thursday night.

The committee decides not only on the discount rate but also sets the federal funds rate, which is what banks charge each other for overnight loans. While it can change either rate between regular meetings, it has done so only rarely. The last such change came when the federal funds rate was cut just before the markets opened after the attacks of Sept. 11, 2001.

The federal funds rate is used as a benchmark for much of the borrowing in the economy and therefore is more widely followed than the discount rate. By changing the discount rate without moving federal funds, "you are talking about how they acted in the dark ages back in the '80s," said James McGibany, professor of economics at Marquette University. It's a rather old-fashioned action.

The Fed said it was cutting the rate "to provide depositories with greater assurance about the cost and availability of funding."

### **Broader rate may change**

Many observers said Friday's action means the federal funds rate will be cut from 5.25%, perhaps even before the next scheduled meeting of the Open Market Committee, set for Sept. 18. The committee last met Aug. 7.

"I see this statement as paving the way for a formal rate cut in the Fed Funds target rate in September, perhaps sooner," Scott Anderson, senior economist for Wells Fargo Economics in Minneapolis, wrote in a note sent to clients Friday. "The Fed has clearly blinked."

Using interest rate policy to rescue lenders who have made bad loans is risky because it might allow future investors to think the Fed will bail them out from bad decisions, said Mark J. Ready, professor of business at the University of Wisconsin-Madison.

But in this case, there is a good argument for intervention, he said.

"This is exactly what the Fed is there for," Ready said. "If there is a liquidity squeeze, they don't let things shut down."

Borrowing from the Fed is not done by many smaller banks, said Dick Hansen, president and chief executive officer of Johnson Financial Group, Racine. "Historically it was perceived you might have some problems and challenges if you are going to the discount window to borrow," he said.

But he added: "What the Fed is really signaling here is it is OK to use us. Go about your business of being a lender and lend to borrowers and companies that are deserving of the credit."