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## Fed Trims Rates Sharply, Sending the Markets Up

By [EDMUND L. ANDREWS](#)

**WASHINGTON** — The Federal Reserve reduced short-term interest rates for the sixth time in six months on Tuesday, capping an extraordinary series of measures it has taken to stabilize financial markets. The cut was smaller than investors had been expecting, though, and exposed some signs of a split among policy makers.

The central bank lowered its federal funds rate — the rate it charges banks for overnight loans — by three-quarters of a percentage point, to 2.25 percent, and left the door open to additional rate cuts in the months ahead.

Though it was one of the biggest one-day rate cuts in decades, investors had been betting heavily that the Fed would cut its benchmark rate a full percentage point in response to strong evidence that a recession has begun and to the deepening crisis on Wall Street.

But two members of the Fed's policy-making committee dissented, saying they favored an even smaller rate cut, and the policy group as a whole expressed new worries about inflation — a possible argument against aggressive rate cuts.

"Inflation has been elevated, and some indicators of inflation expectations have risen," the Fed said in a statement that accompanied the rate decision. "It will be necessary to continue to monitor developments carefully."

Some analysts saw the cut of three-quarters of a point as a compromise to appease those who wanted less. Others surmised that the Fed might have been reluctant to cut rates further immediately in part because as the rates inch closer to zero, the Fed leaves itself less room to maneuver in case of further financial shocks.

Investors reacted ambivalently to the initial news of the rate cut but pushed stock prices sharply higher by the end of the day. A rally began in the morning after two major investment firms, [Goldman Sachs](#) and [Lehman Brothers](#), reported profits that were higher than expected and reassured investors that they had adequate capital. Stock prices pulled back within minutes of the Fed's afternoon announcement, before resuming their rise.

By the day's end, the Dow Jones industrial average was up 420 points, or 3.51 percent, to 12,392.66.

The Fed's statement and the vote highlighted a growing conflict about how to lift the economy out of a downturn while controlling inflationary pressures, which have become apparent in the falling value of the dollar and the prices of everything from energy to food.

The Fed chairman, [Ben S. Bernanke](#), has in recent weeks put top priority on propping up the economy, by both reducing interest rates and by unveiling a blizzard of emergency loan programs for cash-short banks and investment firms.

Frederic S. Mishkin, a Fed governor who is close to Mr. Bernanke, has argued in several recent speeches that some indicators of inflation pressure, like the falling dollar or the yields on inflation-adjusted Treasury securities, are not as ominous as they might appear.

The two dissenters in Tuesday's decision were Richard W. Fisher, president of the Dallas Fed, and Charles I. Plosser, president of the Philadelphia Fed, both of whom have been outspokenly hawkish about inflation issues in recent months.

Several analysts said the dissent and the Fed's warning on inflation indicated that policy makers struggled to agree on even the smaller rate reduction.

"I'm disappointed," said Robert V. DiClemente, chief United States economist at [Citigroup](#). "It's not as if we're trying to gauge policy priorities on a sunny day. I'd like to know how you're going to get inflation in an environment with suffocating financial restraint and pervasive slowing in demand."

Mr. Bernanke, who took over as Fed chairman two years ago, has been more open to debate and dissent among policy makers than his most recent predecessor, [Alan Greenspan](#).

Mr. Bernanke and other top Fed officials have acknowledged that consumer prices are rising faster than they would like, but they have predicted that inflation pressures will abate in part because of slowing economic growth.

In its statement on Tuesday, the Fed reiterated Mr. Bernanke's prediction that inflation would probably "moderate" in the months ahead. But it also cautioned that "uncertainty about the inflation outlook has increased."

Ethan Harris, chief economist at Lehman Brothers, discounted the inflation warning as "boilerplate" language intended to assuage the Fed's inflation hawks.

"I don't take it seriously," Mr. Harris said. "The upside risks on inflation are actually very low. The economy is really quite weak, and we are probably in a recession right now. We're just at the beginnings of a consumer slowdown."

With the growing financial anxieties, economic concerns have replaced the war in Iraq as the dominant issue in the presidential campaign.

Democrats in Congress and on the campaign trail have blasted President Bush, saying that he has responded too slowly and supported the bailout of banks and investment firms but not homeowners.

On Tuesday, just as the Fed was announcing its rate cut, Mr. Bush continued to act as cheerleader in chief by emphasizing the economy's underlying strength.

"I understand there's short-term difficulty," he told workers and local lawmakers in Jacksonville, Fla. "But I

want people to understand that in the long term, we're going to be just fine. People will still be able to work."

Without offering any details, Mr. Bush said the government would do more if necessary. "The point I want to make to you is, if there needs to be further action we'll take it — in a way that does not damage the long-term health of our economy."

Many private economists contend that the economy has already slipped into a recession. The Labor Department estimates that the nation lost 63,000 payroll jobs in February, the second straight month of job losses and the third month of job losses in the private sector.

But the Fed's biggest worry in recent days has been on Wall Street, where investors have become so frightened about the rapidly deepening losses in mortgage-backed securities that credit markets have become increasingly paralyzed.

Mr. Bernanke has stunned investors over the past several weeks by unveiling a series of increasingly bold programs to lend hundreds of billions of dollars to banks and Wall Street investment firms.

On Sunday, Fed officials agreed to lend up to \$30 billion to [JPMorgan Chase](#) to engineer its takeover of [Bear Stearns](#), a major Wall Street firm that was near collapse.

But the Fed's most powerful weapon against a slowdown is lower interest rates.

With the latest reduction, the federal funds rate is far below the rate of inflation, meaning that the "real," or inflation-adjusted, interest rate is below zero. It is also well below the [European Central Bank's](#) benchmark interest rate of 4 percent or the Bank of England's rate of 5.25 percent.

A lower federal funds rate usually leads to lower interest rates for commercial borrowing and for consumer loans like mortgages.

Mr. Bernanke has offered few hints about what the Fed might do if its current efforts fail to stabilize the markets or the economy.

But analysts said the Fed had a long list of options. Having already agreed to accept mortgage-backed securities and other securities as collateral for loans to banks and investment firms, the Fed could go one step further and start buying up hard-to-sell securities itself.

If the Federal Reserve feels compelled to reduce the fed funds rate even more, it would have to start grappling with the question of what to do if the rate declines to zero.

In 2003, when the overnight rate was heading to new lows, Mr. Bernanke himself suggested one possible course of action — the Fed could easily infuse more money into the economy by buying up billions of dollars in longer-term Treasury securities and perhaps even commercial bonds.

*Steven Lee Myers contributed reporting from Jacksonville, Fla.*

