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Fed cuts key interest rates

October 15, 1998: 8:11 p.m. ET

Central bank shocks Street with interest rate cut, market soars

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NEW YORK (CNNfn) - In the clearest sign yet that Alan Greenspan is concerned about an economic slowdown in the United States, the Federal Reserve Thursday cut short term interest rates by a quarter point.

The move, the second time the Fed has cut rates in less than three weeks, shocked investors, sending U.S. stock and bond markets soaring.

Industry analysts said the cut, coming nearly a month before the Fed's Open Market Committe is scheduled to meet again to assess monetary policy, shows the U.S. central bank is keen on keeping the U.S. economy from faltering.

"This tells me the Fed is correctly looking forward, looking at the risk of consumers pulling back in spending because stocks have fallen," said Prudential Securities analyst Michelle Laughlin. "They're working in anticipation of that to make sure the U.S. economy does not slip into recession. I'm very encouraged by the Fed's action."

As news of the rate cut hit the floor of the New York Stock Exchange, traders actually cheered and investors rushed to buy stocks and bonds.

The Dow Jones industrial average surged more than 330 points to 8299, the third-largest one-day point gain in history. Bond markets also rallied with the benchmark 30-year Treasury issue surging 1-1/32 in price to 108-9/32.

Banks cut prime, cheaper rates ahead

Experts said the rate cuts are likely to be a boon to consumers who should see cheaper lending rates for such items as cars and homes.

"This means people will be able to go out and refinance their house where they may not have been able to do before and I think that we have to remember this isn't over," John Ryding, an economist with Bear Stearns, told CNNfn. "I suspect the Fed will cut rates again in November and that will continue to keep a lid on borrowing costs and hopefully will compensate for some of the lack of credit flows to corporations that problems in the bond market have caused."

Indeed, within minutes of the announcement, Bank One Corp. (ONE) announced it had cut its prime lending rate to 8 percent from 8.25 percent. Other banks, including Chase Manhattan Bank (CMB) and First Union Corp. (FTU) quickly followed suit.

The Fed cut the federal funds rate and the discount rate by one-quarter of a percentage point each, moving the Fed funds rate to 5 percent and the discount rate, which is charged on emergency loans to commercial banks, to 4.75 percent.

In a brief statement issued just before the markets had closed, the Fed said caution by lenders and volatile market conditions were likely to restrain "aggregate demand" in the future.

"Against this backdrop, further easing of the stance of monetary policy was judged to be warranted to sustain economic growth in the context of contained inflation," the Fed said in a statement.

The last time the Fed cut the discount rate was January 1996. However, on Sept. 29, the Fed cut the federal funds rate, an overnight bank lending rate that is a benchmark for other short-term interest rates, by one-quarter of a percentage point.

U.S. stock markets tumbled the following day as economists and investors expressed disappointment that the Fed didn't implement a deeper cut.

Economists expected the Fed to cut rates again when its policy-making Open Market Committee meets again Nov. 17. But Thursday's move took Wall Street by surprise because the Fed rarely makes a move on interest rates between meetings.

Ryding said the Fed may have been prompted to move more quickly because it feared a credit crunch could further undermine consumer confidence.

"This was actually an interest rate cut stimulated by the problems in Wall Street but really is aimed at Main Street," he said.

"If the Fed does its job people may not notice anything has happened because the Fed will succeed in sustaining economic growth in 1999 and overcoming some of these forces that are head winds to the economy's forward progress that are coming from Asia and Russia."

The last time the Fed made an inter-meeting rate-cut move was in Spring 1994.

William Sullivan, money market economist at Morgan Stanley Dean Witter, told CNNfn that the Fed's move illustrates its policy intentions.

"The Fed is continuing to study credit tea leaves, and perhaps they sense there's more stresses out there and they want to be in front of that by providing liquidity and communicating their support to the marketplace," Sullivan said.

But Sullivan also warned that an additional rate cut may also indicate that all is not rosy in the U.S. economy. Given that the market has begun to stabilize, he said, the Fed's move is a signal that credit risk exposures may be greater than anticipated. [297K WAV] or [297K AIFF]

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