Financial Week
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Bernanke & Co. cut interest rates by half a point; stocks rally

By Andrew Osterland
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The credit crunch overcame the fear of inflation.

The Federal Open Market Committee cut the federal funds rate—the rate that banks charge each other for overnight loans—by 50 basis points to 4.75% today, marking the first such rate cut in four years, and the first under Fed chairman Ben Bernanke.

“Today’s action 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,” the rate-setting committee said in a statement.

The statement suggested that the FOMC was now more concerned with financial market volatility than with inflation pressures in the economy. It did, however, squeeze its inflation paragraph into the statement, promising that “it will continue to monitor inflation developments carefully.”

“I don’t think they wanted to cut rates at all, but they probably felt

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that if they didn't, it could cause more volatility and exacerbate the credit crunch," said Steven Sheldon, president of Houston-based investment advisory firm SMS Capital Management. "Outside the residential real estate market, things have been holding up pretty well in the economy."

Mr. Sheldon, like many on Wall Street, was expecting a quarter-point cut in rates, because few other sectors in the economy have yet to show weakness.

The members of the committee however, apparently had enough evidence to justify the rate cut that many expected might come in between scheduled meetings given the recent chaos in the credit markets.

Two recent economic indicators may have pushed the committee to act as aggressively as it did. The purchasing managers' index from the Institute for Supply Chain Management fell to 52.9 in August. And Bureau of Labor Statistics earlier this month showed the first decline in non-farm payrolls (down 4,000 jobs) in almost four years.

The board also unanimously approved a 50-basis-point decrease in the discount rate to 5.25%. The rate represents interest that member banks pay to the Federal Reserve to borrow money. Robert Johnson, managing director of the CFA Institute, said that cutting both rates suggests the Fed is committed to bringing down rates.

"The discount rate is largely symbolic, but the coupling of the two rate cuts makes a bold statement that the committee is intent on easing monetary policy longer term," Mr. Johnson said.

The Fed's move sent stock prices soaring. The Dow Jones industrial average was up 305 points, or 2.3%, at 13,708 in late trading.

"Don't fight against the Fed," said Mr. Sheldon. "Stocks do well when they cut interest rates."

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