



U.S. CENTRAL BANK LOWERS KEY INTEREST RATES TO BOOST ECONOMY

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The Federal Reserve, the nation's central bank, lowered two key interest rates to prevent problems in the housing market from seeping into the U.S. economy and causing a recession.

The Federal Reserve cut the federal funds rate, the amount of interest that banks pay other banks to borrow money overnight, by half a percentage point from 5.25 percent to 4.75 percent.

The Fed also cut the discount rate, the amount charged on loans to banks, by the same amount, dropping it to 5.25 percent.

In a statement, the Federal Reserve said, "The tightening of credit conditions has the potential to intensify the housing correction and to restrain economic growth more generally."

This is the first cut in this interest rate in four years and economists hope that by making it cheaper for banks to borrow money they will be more likely to lend money to consumers for such things as cars, homes or small businesses.

And when consumers can more easily borrow money, the overall economy is stimulated.

Troubled housing market

Economists say that the rate cut was a response to a drop in housing prices and trouble in the mortgage and lending industries.

Over the past year, many people who borrowed money to purchase homes have seen the interest rates on their loans rise. At the same time, the price of the average house dropped. In some cities, homes have fallen by hundreds of thousands of dollars since 2005.

As payments each month get more expensive and houses are worth less, many people who are unable to pay their mortgages -- or home loans -- are losing their homes to the bank in foreclosure.

Many of these people were what are called subprime borrowers. They were given expensive home loans even if they did not necessarily have the money to continue to pay their monthly bills when the interest rates increased.

When this happens to a lot of people at the same time the people and financial institutions who lend this money in the first place are more reluctant to do so and it's harder for most people to borrow money.

The fed says 'we're on top of things'

But the rate cut is a way for the federal government to respond to this crisis and keep it from creating a recession—a period of economic slowdown.

"What it does is it sends a very strong signal to markets that the fed is on top of things, that the fed does not want this crunch to become anything worse, and especially not to spill over to the rest of the economy," economist Nariman Behraves from Global insight told National Public Radio.

"So it's a way of signaling to the market, 'we know there's a problem, we're doing something about it. Don't worry, don't panic,'" he added.

A bigger cut

Market analysts expected the cut to be smaller, only a quarter of a percentage point, and in response to the bigger cut, the stock market rose. On Tuesday the Dow Jones Industrials rose by 336 points, its biggest one-day point gain in five years.

"I think they're trying to shock the patient back to life," Ethan Harris, chief economist of Lehman Brothers, told the Washington Post.

"Instead of a series of measured, modest steps to they and keep the economy growing, the Fed appeared inclined to take bold action that might calm financial markets and abruptly halt any further slide in economic growth," he added.

Inflation fears

But some economists think the rate cut was a mistake and that the Federal Reserve, led by economist Ben Bernanke, should be concerned more about inflation fears.

Inflation is when there is too much money in the system and the prices of everyday items rises.

"If we get a few decent economic numbers in the next couple of months and some signs of inflation, all of a sudden Bernanke has put himself in a tough spot," Richard Yamarone, chief economist of Argus Research, told the Washington Post.

-- Compiled by Annie Schleicher for NewsHour Extra

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