Central Banks Launch Coordinated Attack; Emergency Rate Cuts Fail to Halt Stock Slide; U.S. Treasury Considers Buying Stakes in Banks as Direct Move to Shore Up Capital

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Abstract: On Wednesday, central banks in the U.S., the euro zone, the U.K., Canada, Sweden and Switzerland each cut short-term interest rates by a half percentage point, noting that "the recent intensification of the financial crisis has augmented the downside risks to growth." Later, central banks in South Korean and Taiwan cut interest rates, too, and Brazil's central bank cut reserve requirements on cash and term deposits.

Full text: The world's central banks launched a large coordinated attack against the widening global financial crisis, lowering short-term interest rates in unison.

Separately, the U.S. Treasury Department is considering ways to inject capital directly into banks, possibly by taking equity stakes. Treasury Secretary Henry Paulson, in a marked shift in rhetoric, played up Treasury's newfound authority to "inject capital into financial institutions."

Treasury is trying to figuring out how to structure such capital infusions so that banks can recapitalize and begin lending, according to a person familiar with the matter. No such moves are imminent.

The emergency interest-rate action, which involved the Fed, the European Central Bank, the Bank of England and others, is a sign that fears that the financial crisis could cripple the global economy are spreading rapidly.

But the rate move failed to soothe jittery investors. The Dow Jones Industrial Average closed at 9258.10, down 189 points, or 2%. The index has fallen 14.6% so far this month. Oil fell $1.11 to $88.95 a barrel, on signs of weakening global demand. Investors continued to flock to safe-haven U.S. Treasury bills, and away from riskier debt such as junk bonds.

One of the chief threats to the global economy is that banks and other financial institutions are hoarding cash, which makes it harder for businesses and households to finance their day-to-day affairs. Lower interest rates reduce the cost of borrowing for banks, businesses and households, and potentially boost confidence. But it's far from clear whether the lower rates will make banks and other lenders, which are gripped by fears of defaults by borrowers, any more willing to lend.

The U.K. government this week announced a plan to take stakes in a range of domestic banks. As recently as a few days ago, the U.S. Treasury was not considering any capital injections. But it has become more of a possibility as the stock market has plunged and the credit crunch shows no signs of easing.

Treasury wants to design something voluntary that encourages healthy institutions to participate. It is discussing whether to buy preferred stock or find some other way to inject capital into the firms.

In remarks to reporters on Wednesday, Mr. Paulson said its new authority extends beyond just mortgage-related assets to "any other troubled assets that the Treasury and the Federal Reserve deem necessary to promote financial market stability." On Wednesday, central banks in the U.S., the euro zone, the U.K., Canada, Sweden and Switzerland each cut short-term interest rates by a half percentage point, noting that "the recent intensification of the financial crisis has augmented the downside risks to growth." Acting on its own, the People's Bank of China also cut rates, as did Australia's central bank, a day earlier. Later, central banks in South Korean and Taiwan cut interest rates, too, and Brazil's central bank cut reserve requirements on cash and term deposits.

The global scope of the move was unprecedented, and the cuts marked the first time central banks across the Atlantic have moved in tandem on interest-rate policy since just after the Sept. 11, 2001, terrorist attacks in the U.S. The Fed has not moved rates since April, when it lowered them to 2%.

The moves likely mark just the beginning of broadened government efforts to keep the world-wide credit freeze from strangling the global economy. "For all central banks, this is not the end of the story," says Laurence

Meyer, vice chairman of Macroeconomic Advisers, a forecasting firm, and a former Federal Reserve governor. "We're facing a potentially severe recession."

Many investors already expect further interest-rate cuts in the euro zone, the U.K., the U.S. and elsewhere in the months ahead, though much will depend on how the markets behave. U.S. officials are likely to move quickly to implement other plans that already have been announced, including a Treasury Department program to spend up to $700 billion to buy risky assets from banks, and a Fed plan to lend directly to a wide range of U.S. companies through the commercial- paper market.

With finance ministers from around the world gathering for the International Monetary Fund's annual meeting in Washington this week, officials could begin looking for other ways to coordinate their efforts. They could commit to boost government spending or cut taxes to stimulate growth.

But there will be limits to how much they can accomplish. While it is relatively simple for central banks to manipulate interest rates together, it is far more difficult to align the international politics of taxation and spending.

The interest-rate cuts announced Wednesday came together over just a few days, as the Fed was separately planning a rescue of the damaged U.S. commercial-paper market, and European governments scrambled to address a series of bank failures. The heads of the Fed, the European Central Bank and the Bank of England began a series of telephone discussions about a coordinated attack on rates.

They came together on a conference call early Tuesday morning, U.S. time. Fed Chairman Ben Bernanke initiated the call. He was joined by Bank of England head Mervyn King and Jean-Claude Trichet, head of the ECB. They agreed that coordinated rate cuts were needed, and that they would go to their respective policy-making boards. The three men also agreed to issue a statement acknowledging the growing threat of the crisis and arguing that inflation pressures were moderating. Messrs. Bernanke and King had been academic colleagues in the Massachusetts Institute of Technology economics department.

Mark Carney, governor of the Bank of Canada, was also on the call, and also agreed to the cut. Masaaki Shirakawa, head of the Bank of Japan, listened in, unprepared to move because Japanese rates are already very low. Central banks from Switzerland and Sweden joined in the rate cut.

Officials from the People's Bank of China weren't on the Tuesday call, and weren't part of the joint effort. But they moved almost simultaneously.

The Fed has been more aggressive than other central banks in using interest rates to try to stem the financial crisis. Since September 2007, it has pushed the federal-funds rate down to 1.5% from 5.25%. With the latest move, it has set aside the inflation worries that had dominated policy discussions in the middle of the year.

Officials hope the move will deliver a shot of confidence to reeling credit markets. But it puts them in a tricky spot. At 1.5%, rates don't have room to go much lower.

"The worst-case scenario is that the Fed loses its ability to stimulate further as the funds rate moves to zero," says Mr. Meyer. His forecasting firm sees the U.S. unemployment rate rising to 7% in the next year; he says it could go to 8% or even higher if credit markets don't begin to improve.

U.S. officials are conscious of the dilemma, and are expected to move forward quickly in the days ahead with other efforts to stem the crisis.

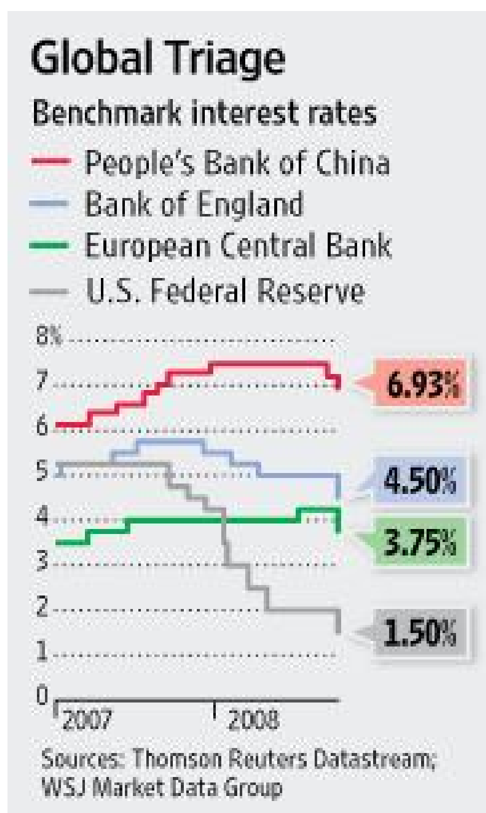
"Monetary policy by itself can't solve the problems in credit markets, but it has a very important role to play in any case," says Frederic Mishkin, a Columbia University economics professor and former Fed governor.

For the European Central Bank, market turmoil has prompted a fast about-face. As recently as July, it was concerned enough about inflation to raise its key rate to 4.25%, from 4%,

Unlike the Fed, which is charged both with supporting growth and controlling inflation, the ECB's single mandate is to keep euro-zone prices steady. Inflation in the 15 countries that share the euro currency, an economy second in size to the U.S., was 3.6% in September, well above the central bank's preferred rate of just below 2%.

Mr. Trichet set the stage for coordinated action last week when he acknowledged that the intensifying market turmoil had radically changed policy makers' calculus. At the ECB's meeting last Thursday, which came on the heels of four dramatic European bank rescues by six different governments, policy makers acknowledged the euro-zone economy would be hit harder by the market turmoil than previously expected, and that sharply slower growth would drag inflation down with it.
Late Tuesday night, with European governments grappling for solutions to the crisis taking hold across the continent, the bank's 21-member Governing Council, on a teleconference call, agreed to take part in the global rate cut. The cut reduced the ECB's key rate to 3.75%, from 4.25%.
Meanwhile, Mr. Bernanke started to get his own message out. On Tuesday afternoon, he told an audience of economists at the National Association for Business Economics that the economic outlook had worsened, and that the Fed would have to look at its interest-rate options.
The Federal Open Market Committee convened Tuesday evening at 5:30 to put its seal of approval on the decision. The vote was unanimous, a sign that the inflation worries that had divided some members earlier this year had been tossed aside for now.

Deborah Solomon contributed to this article.



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