

U.S., Britain Up Ante in Fight to Stop Crisis; Fed to Lend Directly to Companies for First Time Since Great Depression, Hints at a Rate Cut; Stocks Fall as Dow Hits 5-Year Low

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Abstract: The Federal Reserve said it will bypass ailing banks and lend directly to American corporations for the first time since the Great Depression, and it hinted strongly at further interest-rate cuts -- a cocktail of unconventional and conventional remedies for an economy whose prognosis is deteriorating rapidly. In his remarks Tuesday, the Fed chairman played down the risk of inflation, noting that oil prices and other commodity prices are off their peaks, and U.S. import prices show signs of decelerating.

Full text: The Federal Reserve said it will bypass ailing banks and lend directly to American corporations for the first time since the Great Depression, and it hinted strongly at further interest-rate cuts -- a cocktail of unconventional and conventional remedies for an economy whose prognosis is deteriorating rapidly.

The historic and potentially risky move of lending to nonfinancial corporations, the latest in a string of extraordinary steps taken by the Fed over the past month, carries the government deeper into the role of propping up private markets. Investors remain unconvinced any of it will work.

Stocks continued their relentless decline on Tuesday amid fresh concerns about the health of financial institutions. The Dow Jones Industrial Average fell 508.39 points, or 5.11%, to 9447.11, its lowest closing in five years. Shares of Morgan Stanley fell 21%, and American International Group Inc., which already received a government bailout, saw its shares drop 9.3%. Over the past year, the U.S. stock market has lost \$7.2 trillion in market value, as measured by the Dow Jones Wilshire 5000 index, which includes almost all U.S. companies. Stock markets in Asia continued their decline Wednesday morning, with Tokyo's Nikkei Stock Average down 4.5%.

Fed Chairman Ben Bernanke, in a speech Tuesday to the National Association for Business Economics, said that history showed that the financial crisis would "take a heavy toll on the broader economy, if left unchecked." The Fed's move on Tuesday aimed to unclog the market for "commercial paper," essentially IOUs issued by banks and companies. Companies ranging from AT&T Inc. to General Electric Co. to United Parcel Service Inc., along with many U.S. and European financial firms, tap this \$1.6 trillion market for short-term loans to fund their day-to-day operations.

The central bank, with the backing of the U.S. Treasury, said it would make loans directly to companies in this market. The move potentially puts taxpayers on the hook for new losses. Many commercial-paper loans are not secured by collateral. Though the Fed took a variety of steps to minimize its exposure, including asking borrowers to pay upfront fees, the government could suffer losses if corporate defaults rise and those steps prove insufficient.

By hinting that it is also considering further rate cuts, the Fed appears to be setting aside the inflation worries that dominated many of its internal discussions earlier this year, and potentially setting its rate target, now at 2%, back toward levels last seen after the 2001 recession.

Rates are already heading lower elsewhere in the world. Australia's central bank surprised investors Tuesday by slashing its key lending rate by a full percentage point. Some effort to coordinate interest-rate cuts among other central banks is a possibility, particularly with annual meetings of the International Monetary Fund approaching this weekend in Washington.

Fed officials hoped the latest moves would restore market confidence, which has virtually disappeared since the collapse of Lehman Brothers Holdings Inc. in mid-September. Lower interest rates could reduce the cost of funding for businesses and individuals at a time of great financial strain. And the government intervention in the commercial-paper market could send a signal to money-market funds that it is still safe to hold these

instruments.

In his remarks Tuesday, the Fed chairman played down the risk of inflation, noting that oil prices and other commodity prices are off their peaks, and U.S. import prices show signs of decelerating.

But cutting interest rates further in the U.S. raises new questions. With rates already at 2%, they don't have much further to go before they hit zero. The last time the Fed pushed interest rates lower than they are now, after the 2001 recession, the move helped set off the housing frenzy that ultimately led to the current crisis. Another speculative frenzy, however, looks highly unlikely today, with so much stress in credit markets.

A bigger potential problem is that cuts could prove ineffective -- Japan's interest rates stood near zero for more than a decade without substantially reviving economic growth.

The Fed's effort to boost the commercial-paper market will draw on Depression-era powers that allow it to lend to anyone under "unusual and exigent" circumstances. The last time the Fed undertook such a program was in the Depression itself -- an industrial-lending effort that started in the mid-1930s and lasted into the early 1940s. Commercial paper is short-term debt, from overnight to a few months in maturity. It is typically purchased by banks or institutional investors such as money-market funds. The Fed will set up a facility called a special-purpose vehicle that will purchase three-month top-rated commercial paper, which represents about \$1.3 trillion of the market.

It said the program will be up and running soon, and would continue buying until April 30, 2009, although that could be extended. It said the U.S. Treasury would make a "special deposit" with the Fed in support of the facility. Details of that deposit were still being sorted out Tuesday. According to one person familiar with the matter, the Treasury could help to finance the program by issuing additional short-term government bills, which it can leave on deposit with the Fed.

Issuers will pay the Fed upfront fees, or will provide guarantees or collateral, to help insulate the central bank from losses. If the Fed loses money on the loans, something officials say they don't expect, U.S. taxpayers would lose, since the Fed's gains and losses are turned over to the U.S. Treasury.

The commercial-paper market has contracted by 10% since July, to \$1.607 trillion, as investors flock to safer terrain. Conditions in the commercial-paper market improved slightly on Tuesday, but some traders said volumes were lower than usual and it took them more time to sell debt to investors.

Money-market funds, by some estimates, hold more than 40% of U.S. commercial paper outstanding. Last month, the Reserve Primary money-market fund, managed by Reserve Management Company Inc., "broke the buck," meaning it fell below \$1 per share after suffering losses on holdings of Lehman Brothers commercial paper holdings. That prompted a "bank run" -- investors fled from so-called prime money funds that hold commercial paper and flocked to safer money funds that invest in government securities.

Prime funds have seen \$500 billion in outflows since last month, while government money funds have grown by \$380 billion, according to research firm iMoneyNet Inc. It is the largest flight to government funds in any four-week measure in history, according to AMG Data Services.

The wave of redemption requests from investors has forced prime money funds to sell billions of dollars in commercial paper they've invested in to raise cash.

The problems are making it more expensive for many big companies to borrow. Two-week commercial-paper issued by at least one company yielded close to 7% on Tuesday. It usually yields between 3% to 4%.

General Electric commercial paper maturing in December, which in normal times would yield 2% to 3%, was yielding above 5% on Tuesday, according to traders. GE's finance arm, GE Capital, is one of the biggest issuers of commercial paper. GE recently had around \$90 billion of commercial paper outstanding.

GE announced plans two weeks ago to reduce its dependence on the market by next year to 10% to 15% of its debt outstanding. A spokesman welcomed the Fed's move, saying it was "an important development that will improve confidence in the market and facilitate more lending."

Another big problem has been that firms have only been able to borrow for a few days at a time, if that. Fed

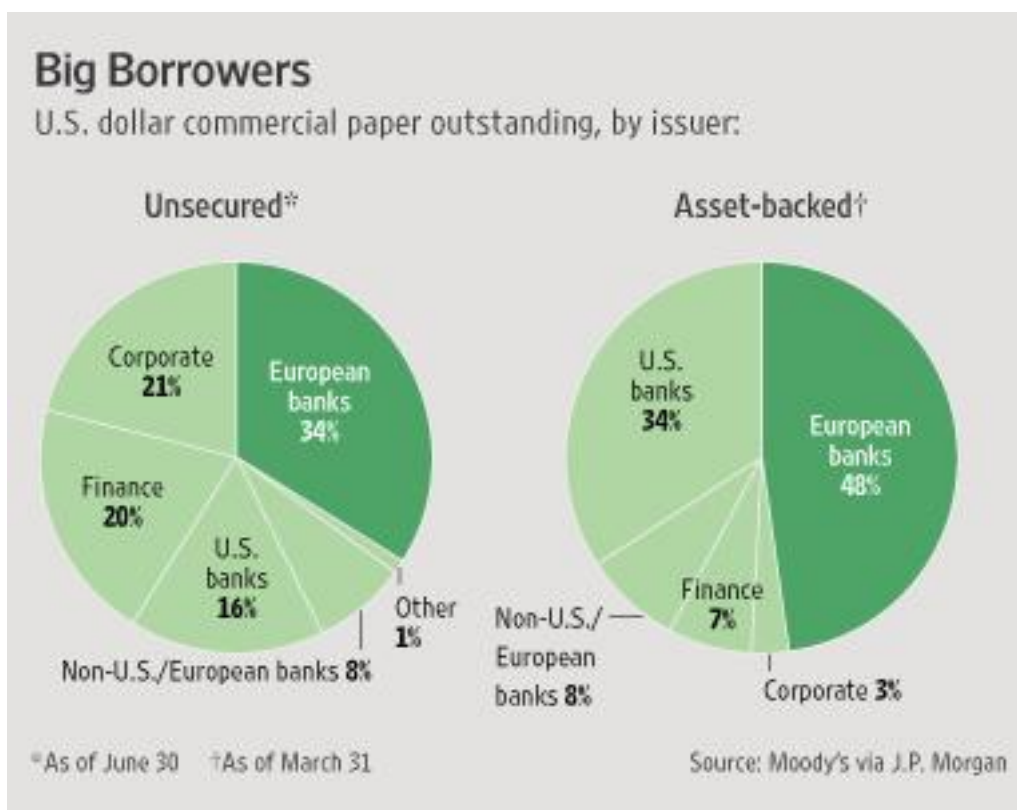
data indicate that more than 80% of U.S. commercial paper outstanding in early October was due to mature in one to four days. In normal times, that proportion is between 40% and 50%.

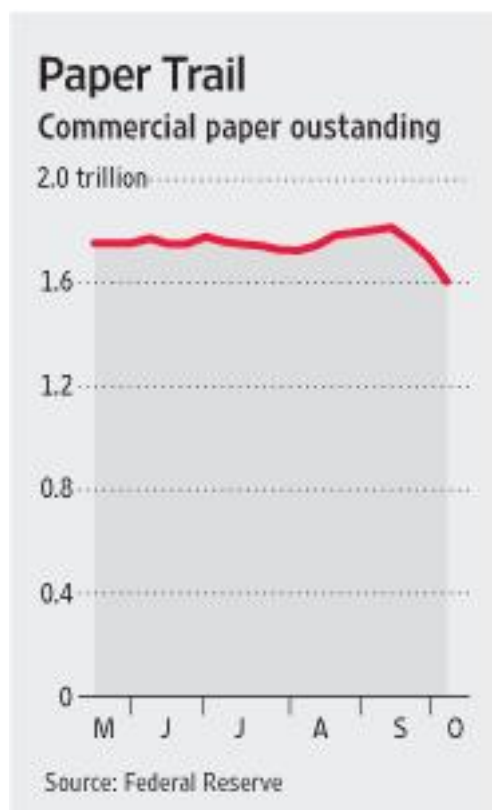
Fed officials have been especially concerned about the inability of firms to issue commercial paper for longer durations. By being stuck with overnight financing, many companies have effectively been operating with guns to their heads -- at any moment, their financing could dry up.

AT&T, which had \$8.5 billion in commercial paper outstanding at the end of June, said that for a two-day period around Sept. 18, just after the bankruptcy-court filing of Lehman Brothers, it only issued overnight commercial paper. Currently, the telecommunications company says it has access to a range of maturities as long as 30 days.

Many firms have been scrambling to pare their exposures. Bank of America Corp., the giant Charlotte, N.C., bank, said late Monday that it had reduced its total commercial paper and other short-term debt outstanding to \$145.8 billion on Sept. 30, down 18% from \$177.8 billion in June.

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