THE WALL STREET JOURNAL.

The Afternoon Report: How Low Can Ben Go?; Online edition

Robin Moroney. **Wall Street Journal**. (Eastern edition). New York, N.Y.: Feb 27, 2008.

Abstract (Summary)
The markets have been concerned that mounting inflationary pressures (such as oil nearing historic highs) would encourage the Federal Reserve to stay put, lest a further interest cuts accelerate inflation out of control. According to his widely adopted Taylor Rule -- which calculates an ideal interest rate taking into account the prospects for growth and the straying of inflation from a target -- the Fed's rate should be one percentage point above the current 3%.

Full Text (1349 words)

Faced with the prospect of stagflation, Federal Reserve Chairman Ben Bernanke made it clear in Capitol Hill testimony today that he's still more worried about the stag' than the 'flation.

He hinted that the Federal Reserve will probably continue to try to grow the economy by cutting interest rates. The Federal Open Market Committee has already cut the fed-funds rate at which banks lend to each other by 2.25 percentage points since September to 3%, including 1.25 percentage points over an eight-day period last month. The markets have been concerned that mounting inflationary pressures (such as oil nearing historic highs) would encourage the Federal Reserve to stay put, lest a further interest cuts accelerate inflation out of control. But Mr. Bernanke made it clear where the Fed's main worries lie. While he didn't use the word recession, he stressed that "it is important to recognize that downside risks to growth remain." He noted that consumer spending has slowed, businesses are struggling with tight credit and that financial markets remain under "considerable stress." He could have also mentioned indicators from today that businesses are hemmed in by the credit crunch: a fall in both the demand for expensive goods and capital spending." Once again, what come out loud and clear in this testimony is that the Fed has become increasingly concerned about negative dynamics in the housing market and mounting stresses in the financial system," said Brian Bethune, an economist for Global Insight.

Some economists testifying ahead of Mr. Bernanke questioned how much more room the Fed had to cut rates. John Taylor, a prominent monetary economist at Stanford University, said the Fed may already have cut interest rates too far. According to his widely adopted Taylor Rule -- which calculates an ideal interest rate taking into account the prospects for growth and the straying of inflation from a target -- the Fed's rate should be one percentage point above the current 3%. "Of course, if further economic weakness pulls the growth rate down [. . .] then additional cuts would be appropriate," he said. Nouriel Roubini, a New York University economist noted for his pessimistic economic predictions of late, said the Fed will eventually lose its ability to counter a recession with lower rates. Aggressive cuts would "lead to a disorderly fall of the U.S. dollar, to foreign private investors pulling the plug on the financing of still large U.S. external deficits and to higher imported inflation," he said. Plus, monetary policy "is relatively ineffective" in boosting today's economy as "there is a glut of housing, consumer durables, automobiles and it will take years to clear that glut."

Housing Slump Hits Fannie Mae, Toll Brothers

The weight of the housing slump is being felt far beyond the confines of subprime mortgages. This morning, government-sponsored mortgage-finance giant Fannie Mae swung to a deep fourth-quarter loss and reported a sharp rise in late payments on loans. Data out today showed new-home sales took their third tumble in a row during January, sinking to the lowest point since early 1995. The housing crunch also reared its ugly head in the earnings of luxury-home builder Toll Brothers, which swung to a net loss. "Ceaseless talk of a recession continues to dampen the mood of consumers in general, whether or not a recession actually occurs," said Chairman and Chief Executive Robert I. Toll. On the bright side, regulator Ofheo said it plans to remove the portfolio-growth caps for Fannie Mae and Freddie Mac on March 1, news that sent their shares sharply higher. The announcement marks a change in the relationship between Ofheo and the two firms, which has been strained by accounting problems that forced them to restate years of earnings.

Ofheo, Bernanke Cheer Stocks