US Federal Reserve cuts interest rates as housing slump, recession deepen

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The US Federal Reserve Board on Wednesday cut its key federal funds interest rate by a quarter point, bringing the overnight rate for inter-bank loans to 2 percent, down from 5.25 percent last September. The widely anticipated move marked the seventh rate cut since the subprime-linked credit crisis erupted last August.

The Fed also announced a quarter-point cut in its discount rate, the interest it charges on direct loans to commercial banks, to 2.25 percent.

In the statement issued by the board’s Federal Open Market Committee, the US central bank signaled its intention to hold off making further rate cuts in the coming months, citing some stabilization of financial markets and rising “inflationary expectations.” All of the major stock indexes gave up early gains and closed marginally down for the day, reacting to the indication that the most aggressive monetary-policy easing in two decades was coming to a halt.

The muted reaction by big investors to the Fed’s narrow rate cut and hint of a pause in further monetary easing reflected a sharp shift in market sentiment since the Fed intervened in March to rescue the investment bank Bear Stearns, guaranteeing $29 billion of its failing mortgage-related assets to induce JPMorgan Chase to take over the collapsing brokerage house.

At the same time, the Fed took the unprecedented step—at least since the Great Depression—of allowing non-depository investment banks to borrow directly from its coffers, in exchange for mortgage-backed debt and other speculative securities whose market value has plummeted in the wake of the housing bust.

The Fed subsequently acknowledged that it took these measures to avoid a likely collapse of the entire financial system. In so doing, it assured the banking and investment industry that the full resources of the US government would be marshaled to shield them from the consequences of years of rampant speculation, predatory lending practices, and deceptive and fraudulent accounting methods.

Since the Bear Stearns rescue, the US stock market has risen by 7 percent overall, and financial stocks have soared, despite ongoing banking losses, plunging home sales and prices, mounting layoffs, slumping consumer spending and a worsening epidemic of home foreclosures.

Citibank, for example, which announced billions more in losses in its first-quarter 2008 earnings report last month, has seen its stock rise by 46 percent since March 17. Bank stock prices have risen in tandem with mounting job cut announcements. The world’s biggest banks and securities firms have cut some 48,000 jobs in the past ten months.

CEO compensation has continued to climb, including at firms that registered disastrous losses and stock price declines. One prime example is Angelo R. Mozilo, the chief executive of Countrywide Financial, the country’s largest mortgage lender and a leading marketer of subprime loans during the housing boom.

This week, Countrywide reported losses of $893 million for the first quarter of 2008, the third straight quarter in which the company suffered steep losses. The firm, facing bankruptcy, is in the process of being taken over by Bank of America.

Last year, Countrywide lost $704 million and its shares declined by 79 percent. In recent months it has slashed 11,000 jobs.

But, according to a filing last week with the Securities and Exchange Commission, Mozilo realized $121.5 million by exercising stock options and was awarded $22.1 million in other forms of compensation.

The Fed has pumped hundreds of billions of dollars into the financial system to unfreeze credit markets and bolster the banks. Virtually nothing has been done, however, to provide relief for tens of millions of working people who are being hit by layoffs, soaring food, heating and gasoline prices and the collapse of housing values.

While the stock market and financial markets have somewhat stabilized, at least for the present, the signs of economic slump and social distress are mounting. On Wednesday, the Commerce Department estimated that US economic activity in the first quarter of this year rose by an anemic 0.6 percent. Much of this growth was the result of climbing business inventories, which suggests that the economy will fall into negative territory in the coming months.

A series of reports issued this week reveal that the housing slump is continuing to deepen, and home foreclosures are rising at a disastrous rate. Standard & Poor’s on Tuesday released its Case-Shiller home price index, which showed a record drop in home prices in 20 key cities of 12.7 percent in February, as compared with year-earlier prices. Home prices declined in the 20 cities by 2.6 percent compared with January, the fastest month-to-month decline in the history of the index.

The pace of the decline has accelerated for nine consecutive months. “There is no sign of a bottom in the numbers,” said David M. Blitzer, chairman of the index committee of Standard & Poor’s.

Home prices are collapsing in virtually every part of the country. The report noted that prices in 19 of the 20 cities have fallen over the past year, with prices in all 20 cities falling month-to-month for six straight months.

The biggest year-over-year declines occurred in Las Vegas and Miami, with declines of more than 20 percent in the past year.

Many economists expect prices to ultimately fall 20 percent to 30 percent from their peak, as measured by the Case-Shiller index. They are now down overall by 14.8 percent.

As long as home prices continue to fall, the credit crisis is likely to continue, since the full scope of the underlying solvency problems in the financial system cannot be determined. With giant banks and brokerages holding hundreds of billions of dollars in assets linked to the housing market, the real value of which cannot be determined, lenders are reluctant to extend credit and financial markets remain volatile.

In another report on the housing collapse, the Commerce Department said sales of new, single-family homes fell by an unexpectedly sharp 8.5 percent in March to the lowest level since 1991. Sales were down 37 percent from a year earlier.

The supply of new homes for sale soared to eleven months' worth, the highest level of unsold homes in almost three decades. Another government report said the number of vacant homes in the US increased by one million over the pat year to a record 18.6 million.

The staggering social consequences of the financial crisis were indicated in a report released Tuesday by RealtyTrac on US home foreclosure filings in the first three months of 2008. The company reported that foreclosure filings rose more than 112 percent over last year. So far this year, over 155,000 families have lost their homes to foreclosure, and one out of every 194 US households has received a foreclosure filing.

In the first quarter of this year, according to RealtyTrac, nearly 650,000 foreclosure filings, which include notices of default, auction sales and bank repossessions, have been issued. This is a 23 percent increase from the first quarter of 2007.

Foreclosures increased in 46 states and 90 of the country's 100 largest metropolitan areas. In Connecticut, filings tripled compared to the first quarter of 2007. In Massachusetts, they rose by 260 percent.

The worst-hit state was Nevada, where one out of every 54 homes received some type of foreclosure filing. In Las Vegas, the state's biggest city, one out of every 44 homes went into foreclosure.

Stockton, California had the highest foreclosure rate of any US metro area, with one out of every 30 homes receiving a notice.

Most of the cities in the list of 20 highest foreclosure regions were in the Sunbelt of the Southwest and California, but the top 20 included Detroit, with the sixth highest foreclosure rate, and Cleveland.

Rick Sharga of RealtyTrac noted that a record number of hybrid adjustable rate mortgages (ARMs), worth $362 billion, will reset this year. According to one press account: "So-called 'exploding ARMs' usually have low introductory rates that reset much higher after two or three years, then readjust as often as every six months after that."

Sharga said, "We expect to see another foreclosure peak in the late third or fourth quarter of the year because of the record number of resets coming."

Another expression of the mounting social crisis is the growing wave of utility shutoffs. A survey by the National Energy Assistance Directors' Association found that the number of families receiving federal assistance funds to pay utility bills is the highest in 16 years. For the 2008 fiscal year, it topped 5.8 million, a 3.8 percent increase over fiscal year 2007.

Some states, such as Nevada and Oklahoma, have experienced double-digit increases in the number of families receiving public assistance to pay their utility and fuel bills. The *New York Times* reported last week that a record number of families could face energy shut-offs over the next two months as a result of stagnant wages and soaring prices for heating and electricity on top of food and fuel costs.

Other indices of deepening recession include:

* The Conference Board's index of consumer sentiment registered a five-year low in April. The index fell for the fourth consecutive month and was at its lowest point since March 2003, ahead of the invasion of Iraq. The April index was at 62.3, a 25-point drop from the reading last January. The Conference Board said the proportion of people who expect their incomes to rise over the next six months decreased to 51.1 percent, the fewest since records began in 1967.

* The Commerce Department reported last week that durable goods orders fell in March for the third consecutive month.

* General Motors announced this week it was slashing production of trucks and SUVs by 143,000 units, resulting in 3,550 layoffs at assembly plants in Michigan, Wisconsin and Ontario. For the US auto industry as a whole, cars and light trucks sold at an average of 15.2 million units in the first three months of 2008, the lowest total since the third quarter of 1998. Standard & Poor's forecast that 14.9 million autos would be sold in 2008, the fewest since 1995.