US Federal Reserve cuts interest rates to near zero

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The Federal Reserve Board on Tuesday cut its benchmark federal funds interest rate from 1 percent to a record low range of zero to one-quarter percent, a bigger than anticipated reduction that indicates the US central bank views the economic situation with increasing alarm.

The unprecedented action marks the tenth consecutive rate cut since the housing and credit bubbles imploded in August of 2007. The statement issued by the Fed's policy-making Federal Open Market Committee (FOMC) provides an indication of the depth of the unfolding economic slump and the extraordinary speed with which it is developing.

The FOMC wrote: "Since the Committee's last meeting [October 28-29], labor market conditions have deteriorated, and the available data indicate that consumer spending, business investment and industrial production have declined. Financial markets remain quite strained and credit conditions tight. Overall, the outlook for economic activity has weakened further."

In the period between the last meeting of the FOMC and this week's meeting, US payrolls have shrunk by more than half a million and the official unemployment rate has risen to 6.7 percent. Other government measures of the labor market that provide a more realistic estimate show unemployment to be well over 10 percent.

The Fed's grim assessment was given added weight by economic data for November released Monday and Tuesday showing an accelerating decline in industrial production, a record fall in homebuilding and a record decline in consumer prices. Taken together, these reports suggest an economy lurching into the deepest and longest recession since the Great Depression of the 1930s.

The federal funds rate is the rate charged for overnight loans between commercial banks. The Fed also announced a 75-basis-point cut in the discount rate, charged for direct loans from the central bank to major commercial banks, to 0.5 percent.

Wall Street reacted enthusiastically to the Fed's move, driving the Dow Jones Industrial Average up nearly 359 points, or 4.20 percent.

In its statement, the Fed went to great lengths to reassure the markets that it would continue to allocate trillions of dollars in public funds to bolster the banks and major financial institutions. "The Federal Reserve," it declared, "will employ all available tools to promote the resumption of sustainable economic growth and to preserve price stability." It said this included the maintenance of "exceptionally low levels" of the federal funds rate "for some time."

Having reduced its target short-term interest rate—its traditional economic tool—virtually to zero, the Fed is discussing new ways to avert a full-scale depression, all of which involve a vast and expanding transfer of cash to banks and other major financial institutions—ultimately at taxpayer expense. "The focus of the Committee's policy going forward," the Fed wrote, "will be to support the functioning of financial markets and stimulate the economy through open market operations and other measures that sustain the size of the Federal Reserve's balance sheet at a high level."

As a result of lending programs and bailouts already undertaken, including those involving financial giants that either failed or are tottering on the brink such as Bear Stearns, Merrill Lynch, Fannie Mae, Freddie Mac, American International Group and Citigroup, the Fed's balance sheet has ballooned since September from about $900 billion to more than $2 trillion. New programs to buy mortgage-backed securities from Fannie Mae and Freddie Mac and securities backed by auto loans and other forms of consumer debt will drive the central bank's balance sheet to about $3 trillion.

The statement issued by the Fed on Tuesday suggested that it is prepared to load its balance sheet with even more massive liabilities. The Fed declared that it "stands ready to expand its purchases of agency [Fannie Mae, Freddie Mac, Federal Home Loan] debt and mortgage-backed securities as conditions warrant." It added that it is "also evaluating the potential benefits of purchasing longer-term Treasury securities" and that it will "consider ways of using its balance sheet to further support credit markets and economic activity."

This implies that the Fed may begin buying up "toxic" mortgage-backed securities that remain on the balance sheets of the major banks and continue to generate huge losses for Wall Street. This was the stated purpose of the $700 billion Troubled Assets Relief Program (TARP) when it was pushed by the Bush administration and the congressional Democratic leadership as the supposed cure-all for recession in September and early October.

Soon after the program was passed by Congress, however, Treasury Secretary Henry Paulson reversed course and decided instead to use the fund to directly transfer cash to the banks. The vast handout to the financial establishment was made without imposing any serious conditions or controls, and the banks have refused to use the government money to increase lending, instead using the taxpayer funds to acquire smaller banks or simply hoard the windfalls to bolster their balance sheets.

Meanwhile, the economy continues to plunge into recession, unemployment, home foreclosures and poverty continue to soar, and virtually no social relief is being provided by the government. On Monday, the Federal Reserve reported that total industrial production in the US, including manufacturing and energy output, declined by 0.6 percent in November from a month earlier, and was off 5.5 percent from a year earlier.

Industrial output is on track to register its worst quarter since 1980, and all indications are that it will decline further in the coming months.

The Commerce Department reported Tuesday that housing starts fell 18.9 percent in November to an annual rate of 625,000, the lowest figure since the government began compiling statistics in 1959. They were down 47 percent from the rate in November 2007, and were considerably lower than economic forecasts. Building permits, an indicator of future residential construction, declined 15.6 percent to a 616,000 pace, also the lowest on record. They were down more than 48 percent from the previous year.

In an ominous sign that the economy is on the brink of a downward deflationary spiral, the Labor Department reported Tuesday that the consumer price index fell 1.7 percent last month, also worse than expected and a record decline.

Also on Tuesday, Goldman Sachs reported a quarterly loss of $2.29 billion, its first quarterly loss since the bank went public in 1999. Up to now Goldman has suffered less damage from the credit and housing crisis than other banks. Its plunge into the red makes clear that the financial system remains highly fragile.

Economists at Macroeconomic Advisers LLC reported that the US gross domestic product is on track to shrink by 6.5 percent in the current quarter, which would make it the worse quarter since 1980.