



SPECIAL COMMENTARY

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Everyone Seems To Have Gotten The Message

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Global Central Banks Cut Interest Rates

The Federal Reserve and central banks around the world, including the Bank of Canada, the Bank of England, the European Central Bank and the Swedish Riksbank each cut their main policy rate by 50 basis points this morning. In addition, the Swiss National Bank eased by 25 basis points and the People's Bank of China cut its main policy rate by 27 basis points. This is the first coordinated rate cut among major central banks since September 2001 (in the immediate aftermath of September 11). The Reserve Bank of Australia did not join in the festivities this morning, but it did slash its policy rate by 100 basis points on Tuesday.

The Fed said that acted "in light of evidence pointing to a weakening of economic activity and a reduction in inflationary pressures." Other central banks also pointed to diminishing inflationary risks as justification for this morning's coordinated rate cuts. Beneath the surface, however, is the intensification of the financial crisis, which really ratcheted up following the takeover of Fannie Mae and Freddie Mac and the ultimate failure at Lehman Brothers. The Fed notes that the deteriorating financial conditions have augmented the downside risks to growth, a fact that is well understood by equity investors.

The British government also announced measures this morning that will help to recapitalize the British banking system. The government will buy up to £50 billion (about \$90 billion) in preferred shares, and it will provide a guarantee for bonds issued by the banks of £250 billion (about \$440 billion).

The two trillion dollar question is will all this action work? Let's start with interest rates. The Fed has already cut interest rates seven times since last September, bringing the federal funds rate down from 5.25 percent to the current 1.50 percent. Most other major central banks, notably the European Central Bank, have been a bit slower in cutting. We look for additional rate cuts from major central banks. In our view the Fed will cut another 50 basis points at its regularly scheduled FOMC meeting on October 29. A final rate cut of 25 basis points in December or January also seems likely. We look for the ECB to cut another 75 basis points over the next few months, and expect the Bank of England to bring its main policy rate down another 150 basis points by early next year. In the near term, lower rates may help to restore some confidence. In the longer term, lower rates should help to stimulate spending.

The other measures that have been announced recently should also help to prop up the global financial system. The Treasury's Troubled Asset Relief Program (TARP) is a positive development, but is not likely to be implemented right away. Early implementation of this program, even on a limited basis, could help to bolster confidence. The steps announced by the British government to recapitalize the banking system should also help to stabilize the global financial system.

However, the recently announced steps are not enough to ward off a global recession. The U.S. economy and most major economies likely will remain in recession through the middle of next year. That said the carnage in the financial markets appears to be pricing in far more weakness than we are currently seeing or are likely to see in the economy. Today's moves should help reduce some of the downside risk to the economy and ultimately lay the groundwork for a recovery.

Global Central Bank Rates

Federal Reserve	1.50%	Peoples Bank of China	6.93%
European Central Bank	3.75%	Swiss National Bank	2.50%
Bank of England	4.50%	Sveriges Riksbank	4.25%
Bank of Canada	2.50%		

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