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What Next?

Officials have taken huge measures to ease the money market strain. And yet inter-bank rates remain elevated at levels that continue to threaten the broader economy. What else can officials do?

Throughout this crisis and even since Lehman went under, officials had to be pushed kicking and screaming to take the incredible steps they have already taken. And yet as in the S&L crisis, and the Great Depression itself, policy makers are arguably still thinking on too small of a scale.

Yes they have committed trillions of dollars all told. But the elevated inter-bank rates even with guarantees (still in the process of being legislated in a number of countries), suggests the steps to date are likely to prove inadequate. Indeed, the UK, which had taken important actions that had seemed to get ahead of the curve, was forced by circumstance to do more today.

There are a few other steps that policy makers can take. First, rather than still try to target overnight rates (Fed funds in US) or the refi rate (euro-zone) for example, officials can engage in a quantitative ease--target for example money supply--like Volcker did, though for opposite reasons.

Second, policy makers can force--yes unpleasant--contracts to be rest from libor to the fed funds target.

Third, if financial intermediaries are unable or unwilling to do their jobs--lending money--the government or central bank may have to consider stepping into the breach.

This of course is not intended to be a comprehensive list. Rather the purpose of the exercise is to suggest some new measures officials may contemplate.

Owing to the opaqueness of the instruments and system, it is not clear how much more de-leveraging is still left to be done. The elevated inter-bank rates are like a fever--the symptom of another deeper problem. The patient can remain sick even after the fever breaks.

Rates will remain high until the de-leveraging eases--until the demand for money, in particular, dollars, is satiated. Ironically, the dollar's marked appreciation since mid-July appears to be aggravating the de-leveraging process--which began in earnest shortly after the ECB hiked rates in early July--which in hindsight looks like a blunder of significant proportions.

Central banks are also likely to continue to aggressively cut interest rates. In part, this may help ease the blow to the real economies. It may also help lower the ceilings--libor--by lowering the floor.

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