The Tonge Telegraph
November 2007

A Treat
The Open Market Committee of the Federal Reserve (FOMC) met on Halloween and dished out a little more candy for the economy. They reduced the federal funds rate by another one quarter percent, after the jolting half-point decrease at their last meeting. This will indeed bolster the economy and the stock markets in the months ahead. Wall Street anticipated-some might say demanded-the decrease . . . and it has come forth.

So, what's the Fed up to? This week's economic report showed very strong growth for the past quarter, and inflation remains within the range of 1 to 2% that Chairman Bernanke has set. Why the decrease? Two possible reasons. First, growth in the economy for the rest of the year is not expected to be robust, something like 1.8% growth instead of 2.5 or even greater. The decrease is something of an insurance policy for the Fed. Second, the housing and mortgage situation may increase its drag on the economy.

Yes, that spooky problem from last summer has not abated. When the mortgage problem first appeared, both the Fed and the Treasury Department declared for the record that the overall economy would not be involved. Well, it has been and they have both changed their tune. The housing situation is not getting better and the problems are exacerbated by the mortgage crisis, which is putting more units on the market, many of them auctioned at very low prices, causing losses in the banking sector and suppressing new home building. Altogether now: "Domino Effect!"

In simple terms, banks have giant portfolios of mortgage loans that are part of their capital base and nobody really knows what the market value of those loans is. The loans are backed up by real estate, so there is an asset, but the value of the asset is questionable. At some real estate auctions, units have sold for half their previous selling price. So the giant portfolios of mortgage loans may only be worth half their face value. What's more, that value may well drop if a tremendous number of housing units come on the market at one time.

This fresh reduction in interest rates will help with both the housing problem and the overall economy. Corporations' cost of borrowing money will be less and therefore business will be easier to do-a good move by a cautious Federal Reserve. They still have some room to maneuver (i.e., lower rates still more) if the economy slows further. If and when the economy picks up and the Swamp Monster inflation looms, they can raise rates again without causing undue stress.

If you are interested in the workings of the Federal Reserve Board, I recommend Alan Greenspan's new book, The Age of Turbulence. In everyday language, he illuminates the Fed's perspective on many of the events of the past 20 years, offering a useful look at what the people of the Federal Reserve do on a daily basis to manage our economy and help other nations manage theirs.

And now, at least for a while, the hobgoblins are back in the trunk.

Tonge Investment Services. 22 Common St. Waterville, ME 04901 T: 800 546 7762 E: rstonge@gwi.net
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