

Insider Q&A sees if Fed can cool 'nasty' mess

Contributed by - The OC Register
03/15/2008

By Johnathan Lansner (The OC Register)

What will central bankers do at Tuesday's meeting? These are times that try the Federal Reserve chairman's soul, as shaky financial markets put Fed boss Ben Bernanke in a tough spot. Will cheaper money, or even flooding the market with extra cash, get people (from small fry to global giants) to take risks again, such as from buying stocks and homes or lending money. They've even had to bailout a Wall Street brokerage. Amid this mess, we asked five experts around town what they thought the Fed could do to get themselves, and the global economy, out of this pickle and what the effort might mean for local housing:

Economist Chris Thornberg, Beacon Economics: "They will cut (rates.) Everything is falling apart. Their \$200 billion injection provided at best a temporary relief to a market that is getting absolutely pummeled. Think about it: those mortgage bond pools were valued with a model that said that the possibility of price declines in the housing market is zero. According to Case-Shiller, the national housing market lost 4.5% of its value in the 4th quarter ALONE. Given the pace of home sales and the current stock of foreclosed homes in California would take 5 months to burn off if every home sale in the market was of a foreclosed property. Wow. This is getting very, very nasty. Mortgage rates are irrelevant at this point in time. In fact I would argue that Bernanke is primarily worried about the health of the financial system. What might work at this point in time? A Federal Bureau of Foreclosed Home Purchases: buy them up and, I don't know what."

Lender Kevin Budde, Countrywide Bank: "Based upon the tame inflation numbers reported (Friday) it opens the door for an immediate cut by the Feds before they meet if they choose. Otherwise the Fed funds futures have priced in a three-quarters of a percentage point cut. Prior to the low inflation number a half-point cut was priced in. The Fed's cutting of rates isn't making a difference on home loan interest rates. It's all about liquidity of mortgage-backed securities and the lack of buyers. If it wasn't for the \$200 billion Treasury swap for securities (that) the Feds allowed this last week, our interest rates would be even higher than they are today. The concern of the Federal Reserve Board has moved quickly from helping the housing market to preventing a complete meltdown of the U.S. financial banking system. Expect to see extreme organized moves by central banks around the world over the next several weeks. We are in the throngs of the abyss right now for the housing market. In time historians will look back and mark this current period in time as the worst of the crisis. It will be fixed and it will improve but it will begin as confidence is restored in the financial system not by the sheer act of cutting rates."

Lender Rich Simmons, Nationwide Lending: "Same old story, Jonathan. Mortgage rates are having little correlation to the Fed's lowering of the short term rates. Who wants to be the bank holding mortgage loans? It is like wanting to be Spitzer's campaign manager. We just need to be patient, let the market take its course, and our local market will then start to make a comeback. It is going to be a hard fall, but O.C. will recover, it always has."

Investment adviser Chip Hanlon, Delta Global Advisors: "The market is usually correct in predicting what the Fed will do with interest rates, and futures are currently saying the Fed will cut rates by three-quarters to a full point next week, a panic-type of move. Because the Fed can only control short-term rates, not the long end, there is no guarantee it will bring down mortgage rates. Even if such a move does bring rates down a bit, however, the real estate market will not be saved. Prices are still far too high, especially given a completely changed lending environment in which the sub-prime buyer essentially no longer exists. The Fed might be able to inflate strongly enough to prop up home prices in nominal terms, but in real terms prices will keep coming down."

Investment adviser Charles Rother, American Strategic Capital: "The Federal Reserve is likely to reduce the discount rate and federal funds target rate by a half point. If there is a surprise, it will be the larger-than-expected decrease of a full point. Currently, the nation's economy is going through a de-leveraging process. As a result, at this time, inflation risk is only a secondary concern. Any decline in interest rates would benefit the California housing market. Given the current housing market, interest rate cuts would likely reduce the subsequent housing price declines and shorten the housing market recovery time."