ND Expert: Fed's rate cut risky for future

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With the biggest one-day reduction of interest rates in history announced Tuesday, the Federal Reserve's attempts to resuscitate the U.S. economy could be a mistake, according to University of Notre Dame economist Nelson Mark.

"The rate cut doesn't speak directly to the problem at hand, which is a seizing up of bank credit. Instead, I would have thought that the Fed would try to bolster confidence by acting as a lender of last resort and providing liquidity to the payments system," said Mark, who specializes in international asset pricing and exchange rate economics.

The Federal Reserve dropped interest rates by three-quarters of a percentage point, to 3.5 percent.

"The headline inflation rate for 2007 was around 4 percent," Mark said. "Setting the real Fed funds rate at 3.5 percent has a good chance of accelerating inflation in 2008, which could turn out to be a huge problem for the Fed down the road."

Last year's steadily rising inflation provided an environment in which companies could raise prices with relative ease.

"If we have another round of cheap credit that adds to consumer demand, we run the risk that firms will raise prices by even more in the future," Mark said.

Source: University of Notre Dame