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Bailout is in the eye of the beholder

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MICHAEL REKSULAK | Saturday, September 15, 2007 at 12:30 am



In feverish anticipation of next week's meeting of the Federal Open Market Committee and given growing expectations of a cut in the all-important Federal Funds rate, the "b" word has entered the discussion with a splash. "It is a bailout," complain those who would see a big rate-cut as an undeserved boon to careless (institutional and hedge fund) investors. "It is not a bailout," reply shaken-up Wall Street mavens who point out recent weak labor market data the same way

an addict would point at confiscated drugs in a police evidence room. An administration official sheepishly joined the chorus when he stated, concerning the foreclosure crisis, "We are not using the 'b' word."

That word stands for "a rescue from financial difficulties," but these days it means so much more. Specifically, tempers flare over the question of who will (should) be rescued. Of course, according to the Oxford English Dictionary, the original spelling "to bale out" (referring to an emergency descent by parachute) goes back to a bundle falling "through a trapdoor."

Presumably, the image of punishing mortgage racketeers by plunging them through a trapdoor would strike a chord with those receiving harrowing foreclosure notices. In Georgia, RealTrac Inc. warned recently, the July foreclosure rate was 2.3 times the national average.

The inevitable anger and frustration is driving politicians in D.C. to actions that some would undoubtedly also deride as an attempted bailout. Items on their list included the FHA Secure plan permitting more refinancing of adjustable rate loans with federally insured fixed rate loans and, this week, providing an additional \$100 million for mortgage counseling programs. Moreover, Congress and the administration are publicly pushing for extra efforts by lenders to renegotiate mortgages rather than foreclose.



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That is exactly where helping out credit markets may become a vehicle for lessening the strain on financially troubled homeowners. Providing additional access to funds through the banking system could relieve the pressure on lenders to quickly take drastic (and wasteful) actions.

[The Fed](#)

has always maintained that it would intervene strongly if the "real economy" seems unduly affected by the gyrations in credit markets. Two high-ranking [Fed](#) officials, economists [Janet Yellen](#) and [Frederic Mishkin](#), repeated as much this week when mentioning increasing threats to consumer spending and growth.

Even so, there is something very unseemly about [Wall Street](#) having clamored for weeks now for the [Fed](#) to cut rates. Market corrections, it seems, are not so efficient when one finds oneself on the wrong end of those. Some champions of free enterprise in (very) good times can now hardly wait for a liquidity bash thrown by the regulator. That by itself should give the voting members at the [Federal Reserve](#) pause. Moral Hazard, an incentive for those who are insured to risk more, is not just an academic term. It has been shown to occur frequently, including in credit markets.

The [Federal Reserve](#) cannot and should not be that insurer. Consequently, a half-point rate cut to 4.75 percent would probably go too far at this point. Cassandras, who warn that the market has already priced such a big reduction into its expectations, will have to wander about the village some more. In the long run, a truly independent [Fed](#) is far more important for the overall economy than one precious to those trying to sway its next decision.

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