

THE WALL STREET JOURNAL.

MARKETBEAT

WSJ.com's inside look at the markets

January 22, 2008, 12:22 pm

Ben Bernanke and Market Surprises

Posted by David Gaffen

Depending on one's vantage point, the Federal Reserve's move today suggests that the monetary policy committee **is finally starting to understand what the markets have known for some time**, or, it's a **panicky effort, a weak-willed response** to gyrations in financial markets.

"I do have a sense that the Fed's rate cut was panic induced," says Scott Watkins, consultant with Anderson Economic Group, as plenty of data is due in the next week. **"They seem to have been prompted to action with yesterday's foreign markets falling steeply**, a lot of anxiety about recession, and some saying the talks of stimulus in terms of a tax cut aren't really necessary given that the Fed could lower rates more."

Either way, it was unexpected — **which is what Ben Bernanke wants**.

The Fed **cut the overnight target interest-rate by 0.75 percentage point to 3.50%** in one fell swoop this morning, action investors had clamored for last week, the week before, and for a while before that, as well. The action underscores Fed Chairman Bernanke's views on surprising the markets, something the FOMC has done a **few times** in the last several months.

[In a 2004 Federal Reserve paper](#), Mr. Bernanke found that surprise was an important element of equity market reaction to monetary policy, finding "on average, a hypothetical unanticipated 25-basis-point cut in the federal funds rate target is associated with about a one percent increase in broad stock indexes." **Conversely, "the market is unlikely to respond to policy actions that were already anticipated,"** he noted in that paper, perhaps a clue as to why the much-rumored rate cut Friday never panned out.

And because the most direct effect of monetary policy actions are in asset prices, Mr. Bernanke clearly sees this as an important part of the process, as **"policymakers try to modify economic behavior in ways that will help to achieve their ultimate objectives."**

The unanswered question is **whether the Fed achieved maximum value from this interest-rate decrease by doing as it did now**, something Tony Crescenzi, chief bond market strategist at Miller Tabak, is unsure about.

"Today's rate cut sets a **burdensome precedent difficult to reverse on demands by financial markets for interest rate cuts,**" he says. "Eventually, the Fed must regain control from the financial markets and it can do so by doing no more than 25 basis points next week, if that."

He suggests the Fed **would have done better to cut rates on the day of the weak jobs data**, or just before his recent speech on the economy, because those moves would have been seen as a reaction to economic trouble, rather than market-based turmoil. But Maryann Hurley, bond strategist at D.A. Davidson & Co., says the actions even now were needed for economic reasons, as it suggests **“they’re finally acknowledging the extent of the problems prevalent in the economy and in the financial system and that they’re not going away soon.”**

ABOUT THIS BLOG

MarketBeat, led by Wall Street Journal Online writer David Gaffen, looks under the hood of Wall Street each day, finding market-moving news and analyzing interesting trends and numbers. The blog is updated several times daily with contributions from reporters at The Wall Street Journal and the Online Journal and includes noteworthy commentary from the best blogs and research notes. Have a comment? Write to marketbeat@wsj.com.