Go slow in tinkering with interest rates

by The Detroit News

The Federal Reserve must carefully monitor the effect of its emergency monetary moves on the value of the dollar, already weak compared with other currencies. In a hurried shift this week, the agency reduced a key lending rate to 3.5 percent - a reaction to tumbling stock prices around the world. The drop appears to have calmed markets for the moment. But long-range unintended consequences, if not monitored and attended to, could make the cure worse than the disease. A weak dollar can be at once good news and bad news.

It makes the cost of American-made goods more competitive on the world market. But a weak dollar translates to less purchasing power for U.S. consumers, making their money worth comparatively less in a global economy.

Balancing the equation has never been easy. But Federal Reserve Chairman Ben Bernanke should take care that - in responding to a worldwide stock market panic - he doesn't damage long-term U.S. interests.

Economists already disagree on the value of Bernanke's new rate cut, partly because of the lag between the cut and any effect it might have on the economy. In effect, Bernanke put more money into the economy by lowering the cost of borrowing, perhaps boosting sagging retail sales and home sales.

But that in itself doesn't automatically address fundamental weaknesses in the U.S. economy including high oil prices, crashing homes values, rising inflation and unemployment.

This week's action "reduced the interest rates to below the inflation rate by a good deal, meaning free money," says David Littmann, senior economist at the Mackinac Center for Public Policy, a free-market think tank in Midland, Mich., and retired chief economist for Comerica Bank.

"That's how we got the housing bubble and the incentives to buy more than you can afford. It feels good today, and they look like saviors. But in effect they have set us up for more distortions, financially and economically, in the next three years."

And that's why Bernanke should go slow in the future. Further emergency tinkering could have a negative effect on the value of the dollar at a time when U.S. monetary policy should be geared toward long-term prosperity, not just short-term fixes.

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