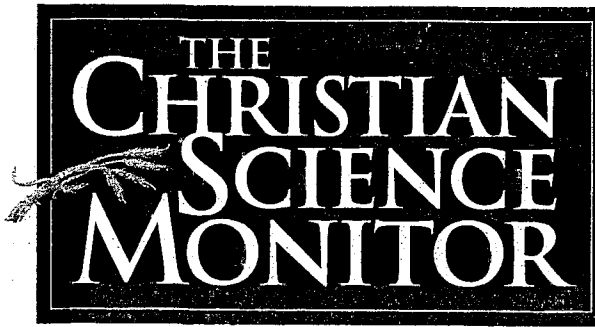


*'To injure no man,
but to bless all mankind'*

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ECONOMIC REPAIR KIT

Fed rides to the rescue carrying ... a crowbar?

■ A big interest-rate cut tomorrow would signal the need for some heavy lifting.

By Ron Scherer
Staff writer of The Christian Science Monitor

NEW YORK – As a tool for tending the economy, interest rates can have the powerful force of a crowbar ... or the light touch of a feather duster.

In coming months, the Federal Reserve Board will be working out how much leverage to apply to rekindle economic growth. An early signal of which approach it favors will come at a meeting tomorrow: If interest rates are cut by another half percentage point, as they were less than four weeks ago, it indicates the Fed believes the

economy needs to be pried up off the floor – the crowbar method. If the cut is smaller, it means the Fed thinks the economy just needs a little pick-me-up.

A large interest-rate cut would not be a surprise. Most economists expect the Fed to reduce rates for several months. "Rates will be down another 1 percent by midyear," predicts Stuart Hoffman, chief economist for PNC Bank in Pittsburgh.

But even a big cut won't be of much immediate help to America's manufacturers, who have

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ECONOMY

For America's factories, interest rates can't fall too fast

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been hit hardest by the economic slowdown and sluggish consumer spending. Whatever the Fed does tomorrow, its action won't be felt on factory floors or Main Street for months.

Initially, in fact, public reaction to another large rate cut may be negative. "People say, 'Boy, if the Fed thinks it's that bad, maybe I ought to wait and see,'" says Mark Zandi, chief economist at The Economy.com, a website. "It takes time for people to get their confidence back and see what the Fed is doing."

Predictably, manufacturers last week were making the case for another crowbar-size rate cut. Today's high cost of energy, combined with the sudden drop in consumer demand, has put industry into a recession, they argue. The Fed's Jan. 3 rate cut was "insufficient if we're serious about averting a recession," says Jerry Jasinowski, president of the National Association of Manufacturers.

As the Fed reduces interest rates, banks begin to lower their prime interest rate (the rate charged to their best customers, but also the base number used for many other loans). Then, as money becomes more available, bankers begin to relax their lending standards, which helps ailing companies.

"It allows people to finance the purchase of computer equipment, telecommunication devices, and new autos," says Mr. Zandi.

Companies have already adjusted their budgets through the beginning of summer, slashing spending on new computers and downscaling expansion plans. Now, the sudden downward push in interest rates is catching them midstride.

Dana Corp. is an example of how a cut in

interest rates could play out on Main Street. Only last August, the company closed a plant in Marine City, Mich., because it couldn't find enough workers. "The company kind of epitomized the late 1990s, when the economy could do no wrong," says John Challenger of Challenger, Gray & Christmas, a Chicago-based outplacement firm.

Now, Dana, which builds axles, drive shafts, and engine parts, is borrowing money, laying off workers, and shutting inefficient plants. But with over 10 percent of its workforce laid off, it needs help from the Fed so its customers start buying new trucks and cars.

"Lower interest rates have a fantastic trickle-down effect," says Gary Corrigan, a spokesman for the Toledo-based company.

Even the whiff of lower rates can make a difference.

On Thursday, Ford Motor Credit raised \$8.2 billion in the bond market. The company had originally planned to borrow \$5 billion. However, demand was so strong that the company dramatically increased the size of its bond issue.

One reason for the rush to buy Ford bonds: an expectation that interest rates will drop again, says Fazal Merchant, manager of Ford Credit's North American and European funding. There will be a ripple effect: Ford plans to use the money to make loans to people buying or leasing Ford vehicles.

For some ailing companies, lower rates

will help, but not totally change, their situation. Take Lucent Technologies, which plans to lay off 10,000 workers after reporting a loss of \$1.7 billion. Last quarter, the firm's interest expense came to only \$129 million. "Even if the rates change by 1 [percentage] point, it would be insignificant to the bottom line," says Michael Ching, an analyst at Merrill Lynch & Co.

But that could change. Lucent recently obtained a \$4.5 billion line of credit. And last week, Moody's Investors Service downgraded the company's debt. If its rating were to drop below investment grade, Lucent's borrowing costs could swell dramatically.

But Lucent could also benefit, because its customers might see their own businesses improve. "To the extent that lower rates allow companies to improve profitability so they can increase IT budgets, it helps the companies I follow," says Mr. Ching, a wireless analyst. "That will not happen overnight - and there are still questions of whether Lucent has the right product for the customer base." Lucent had no comment.

Even some companies in dire straits, such as California's major utilities, could benefit from lower borrowing rates. Although the utilities can no longer borrow money themselves because their credit ratings are so low, the state of California plans to borrow money to help them. "Lower interest rates could help the economics of the state in helping out the situation," says Brian Youngberg an analyst at Edward Jones, a St. Louis brokerage house.

'Lower interest rates have a fantastic trickle-down effect.'

- Gary Corrigan,
spokesman, Dana Corp.