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As we expected, the Federal Reserve (the Fed) and other central banks around the world acted in concert yesterday in attempts to both spur economic activity and provide a positive signal to financial markets that were in desperate need of good news. The Fed reduced its target federal funds rate by 50 basis points—to 1.50 percent from 2.00 percent—moving in concert with the European Central Bank (ECB), the Bank of England, the Bank of Canada, and the central banks of both Sweden and Switzerland—each of which enacted similar 50-basis-point rate cuts. The central banks of Australia, China, and Hong Kong had already reduced their target rates in the past day.

This coordinated move by such a large and diverse group of central banks is unprecedented; the closest historical comparison would be the rate cuts enacted by the Fed and the ECB in the immediate aftermath of the terrorist attacks on September 11, 2001.

The move also represents a drastic policy shift for the ECB in particular, which had steadfastly maintained that it would not cut rates in the face of persistent inflation concerns. The Fed, on the other hand, had become increasingly concerned about weakening domestic economic conditions. The timing of its move—three weeks before its next scheduled meeting—and the unanimous 10–0 vote in favor of the rate cut indicate the sense of urgency with which it acted.

Markets have seesawed today in the aftermath of the announcement. But short-term noise aside, we view the move as an extremely positive next step in the efforts by the Fed and the Treasury to address continuing economic concerns for the longer term. It is also likely, however, that Fed Chairman Ben Bernanke—who witnessed firsthand the credit bubble that formed in the wake of ultra-low interest rate policies in 2003–2004—will tread cautiously in dropping rates further from here. We expect the next phase of the debate will likely be increased rhetoric calling for Congress to enact additional fiscal stimulus programs.

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