

VIEWPOINT

Fed Rate Cut Hasn't Resolved Systemic Economic Weaknesses

By Scott Y. Stuart



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One of a series of opinion columns by bankruptcy professionals.

It is as simple as this: What goes up must come down. In those few but familiar words we describe an economy, the credit markets and the potential for a recession. And the response of the Federal Reserve is to lower the cost of money, pump up the markets and keep the prosperity and growth alive. That being said, is it continued prosperity we are looking towards? Or is the Federal Reserve artificially prolonging a cycle that has run its course?

It was Alan Greenspan who once indicated that unregulated money will adjust to the market conditions of a free market economy. Simplistic as that sounds, shouldn't the same theory apply to the downside of an economic cycle, such as the one we seem to now be experiencing? If the answer to this question is yes, then what the Federal Reserve did not regulate going up should not be touched on its way down. In other words, the recent rate cut is not an answer to a problem; it is a deviation from the course we embarked on through the sea of endless liquidity, minimalist risk assessment and little volatility that preceded the recent economic challenges we face now.

The questions turnaround professionals are now left to ponder all stem from the Federal Reserve's radical rate cut. Will it stop the historic downturn in the housing market? Will it save the subprime market from total collapse? Will lenders fearless of risk just a short time ago become increasingly risk adverse? And will industries seemingly impervious to failure now have to deal with the realities of business consolidation or reorganization?

These are all questions which are the leftovers of a rate cut that may have temporarily stemmed panic, but do not address the systemic problems of an economy on the edge. While the housing market is the most obvious sector to look to for answers to some of these questions, it is not the only area that provides signals. The automotive industry continues to struggle; the dollar continues to be historically weak internationally; and inflationary concerns loom.

While a rate cut may have some short-term benefit, it is very unclear whether it will help us avert an economic downturn or full-blown recession. The economic world is divided on inflationary concerns, as it is on whether we are headed into a recessionary period. What does seem clear is that, at a minimum, our economy is going through a period of adjustment - one that may be long overdue as a result of the confidence years of liquidity gave to those who believed risk no longer existed in the lending environment.

Some investors and economists, such as Jim Rogers and Marc Farber, attribute the current period of instability to artificially low interest rates, expansionary monetary policies and extremely rapid credit growth - factors they do not believe address these fundamental problems. Beyond that, however, it was Ben Bernanke himself who in August commented that "it is not the responsibility of the Federal Reserve - nor would it be appropriate - to protect lenders and investors from the consequences of their financial decisions." Is this not exactly what the Federal Reserve did in this latest great rate cut?

It appears that no one has the guts to call a spade a spade. The economy is weak, yet economists such as Mark Zandi, chief economist at Moody's Economy.com, will only go as far as saying that the economy is very soft, and without a rate cut we could fall into recession. Former Fed Governor Lyle Gramley said he thinks we will escape a recession "by the skin of our teeth."

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Perhaps the real answer is to cope with the downside of this cycle the way we dealt with the upside, which was to let it run its course, a theory some may call irresponsible. We all watched money pouring into our economy on an unregulated basis, which bolstered segments of industry and the housing market, perhaps artificially. Now we face what is at best a correction where few are willing to let contraction occur the way we allowed the expansion to take root. Perhaps the irresponsibility thus comes in trying to prolong something that is at an end and needs restructuring.

For turnaround professionals who ponder these issues, the word of the day should be "preparedness." There is no doubt that the current tentativeness has, with minimal warning, changed the dynamics of many industries. While liquidity lives, terms of lending are changing, risk levels lowering and true analysis of where distress exists occurring at a higher level than in many years. Whether it is a recession or correction, industry consolidation, restructuring and bankruptcy will be a bigger part of the business landscape.

These are our realities - ones which just a few short months ago did not exist. Now, with substantial events like the subprime market collapse and the Federal Reserve trying to hold the flood gates of an economic downturn closed, the turnaround community stands poised to react, counteract and respond in ways that can truly help businesses and provide them with the fortitude and ability to truly turnaround or reorganize. Perhaps the recent rate cut has awakened some sleeping lions just in the nick of time, something that may not be a bad thing for our economy at all.

(Opinions expressed are those of the author or authors, not of Dow Jones Newsletters.)

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Small-Cap Bankruptcy Stock Table

52-Week Hi (\$)	52-Week Lo (\$)	Company	Ticker	Tuesday Close (\$)	\$ Change for Wk	% Change for Week	YTD % Change	5 Sessions Ago Close (\$)	12/31/06 Close (\$)	Shares Out 000s
2.25	0.3	Congoleum Corp New	CGM	0.53	32.50	-16.67%	-68.07%	0.40	1.66	3.6630
0.88	0.07	Large Scale Biology Corp	LSBC	0.10	-16.67	0.00%	-84.62%	0.12	0.65	6.4480
8.72	3.5	Seracare Life Sciences Inc D	SRLSQ	5.50	-1.79	-11.11%	-14.99%	5.60	6.47	18.5380

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